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Leasehold enfranchisement: the latest consultation

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Since the publication, in January 2020 and July 2020, of the Law Commission's reports on reform proposals, those of us practising in the field of enfranchisement (and clients of ours minded to make an enfranchisement claim) have been primed for the introduction of reforms of the law relating to leasehold law generally and enfranchisement in particular. Indeed, if some of the measures put forward by the Law Commission were implemented, the landscape would be markedly different to that which we presently face.

By way of reminder, in accordance with the task set for them, the Law Commission's reports set out a series of options for reform, and for consideration by Government as to which, if any, it wished to pursue. Yet, despite what now seems a flash in the pan in early January 2021, when the Government issued a surprise announcement heralding the possible adoption of some of the Commission's proposals, we have remained in a position of stasis - even as to the majority of those specific few measures set out in that single announcement last year.

Perhaps there is an unknown policy for the release of surprise law reform announcements on the return to work in the New Year. On 11 January 2022, without much by way of prior warning, a further update arrived in the shape of the Government's paper entitled "Reforming the leasehold and commonhold systems in England and Wales".

This latest publication takes the form of a consultation, inviting views on a set of specific proposals for reform. However, it is notable that this is perhaps the clearest indication yet as to the Government's intentions. The opening page to the consultation paper, which contains an introduction, states that the Government "agree in principle that these proposals would fulfil our stated aims to broaden access to enfranchisement and the right to manage and reinvigorate commonhold as a future tenure". This rather has the ring of the Government having already decided to implement these measures unless the responses it receives are radically of the opposite point of view.

The proposals which form the subject matter of the consultation may be summarised as follows:

1. Raising the non-residential limit (currently 25%) for a building which might qualify for a collective enfranchisement claim to 50%
2. Raising the non-residential limit (currently 25%) for a building which might qualify for a RTM claim to 50%
3. Introducing a prescribed non-residential limit (50%) for a building which might qualify for an individual freehold claim.
4. Introducing a right, which might be exercised by tenants making a collective enfranchisement claim, to compel the landlord to take leasebacks of flats held by those tenants not participating in the collective claim.
5. Clarifying the operation of voting rights for owners of shared ownership properties in a commonhold development.
6. Introducing requirements as to the provision of information during the sale of a commonhold property.

There are small flashes of logic amongst these proposals (for example, seeking to ensure that the limit for the non-residential proportion of a building which qualifies for an RTM claim matches that for a building qualifying for a collective enfranchisement claim and, apparently, creating (perhaps a little simplistically) a sense of uniformity in setting a similar ceiling in the context of an individual freehold claim). However, many will know that the suggestions put forward by the Law Commission extend, over hundreds of pages, to several aspects of the law. These need to be resolved and settled as a whole, and the measures which form the subject matter of this latest consultation appear to be an odd collection chosen from the wider debate.

As ever, what will be of prime focus from the list above will be those matters which most affect the reader. However, the following are perhaps of the widest and most immediate impact.

Raising the non-residential limit from 25% to 50% for collective enfranchisement claims

At present, the law provides that, in order for tenants of a building divided into flats to be able to collectively claim the freehold of that building, the proportion of the building given over to non-residential use must be no more than 25% of the floor area of the building as a whole (discounting common parts).

The proposal put forward is to increase that threshold from 25% to 50%.

Each of the proposals in this consultation derive from the Law Commission's report and one might say that, in fairness to the Commission, its inclusion of this particular provision satisfies its remit to present options which would make enfranchisement easier for tenants. It would certainly have that effect, by virtue of the simple fact that it will necessarily open up more buildings to qualifying for a collective claim than is currently the case.

However, it needs to be borne in mind that the Government also maintains that it wishes to balance this stated aim of making enfranchisement easier (and cheaper) for tenants against a recognition of the legitimate interests of the landlord, and there are many that would question whether that balance is achieved here.

At its source, enfranchisement came about to offer rights to those owning residential homes. In the case of collective claims, the inclusion of a condition that no more than a particular proportion of the building should be given over to non-residential use might be seen as an acknowledgement that the building should be primarily residential. Indeed, the legislation began with the non-residential proportion set at 10%. Opening the availability of such rights to buildings of which 50% is in commercial use could be said to be altering that dynamic significantly.

Against this background, it should be noted that until the publication of the Law Commission's report, there had seemed to be no appetite, or particular call, for such a change to be made. Very little mention had been made of it in the written consultations or stakeholder forums which the Commission conducted ahead of its report. Indeed, in response to a formal question about such a move (and as is acknowledged in this latest Government consultation), a majority were in favour of keeping the non-residential limit unchanged.

Now that the proposal has seemingly gathered momentum, it is unlikely that many groups of potential tenant claimants might object (although it is worth noting here that they would be well-advised to give some consideration to the practicalities of taking on the management of a building of which as much as 50% may be in commercial use and the legal obligations and burdens which go with that). However, the proposal is surely going to meet with resistance from landlords who have invested in such buildings. The proposed reform would render vulnerable the freehold to a whole class of buildings, and thereby deprive the landlords concerned of their interest in such buildings in a manner which none would have reasonably foreseen prior to the Commission's report.

Introducing a non-residential limit of 50% for individual freehold claims

For several years, practitioners in this field have sought clarity over the question which is usually reduced to the phrase "when is a house a house?" The Leasehold Reform Act 1967 affords a tenant of a long lease of a "house" the right to claim the freehold of that property. To most outside observers, it might seem extraordinary that there should be any debate over the concept of what class of property might constitute a "house", and yet the definition provided in the 1967 Act has resulted in a great deal of lengthy, and expensive, litigation. Despite several high-profile cases, where it was hoped the Courts would take the opportunity to provide definitive guidance, there has still been no absolute certainty as to when an individual property in mixed use qualifies as a "house".

The Government's proposals seek to resolve that by including provision that there will be an absolutely definitive point at which a single property in mixed use will qualify for the subject of an individual freehold claim, namely that no more than 50% should be in non-residential use.

In part, this seems to have come about as a by-product of the Commission's broader suggested reforms. The Commission puts forward the idea that the enfranchisement legislation be subject to a wholesale change that no longer distinguishes (as it does currently) between flats and houses. The new system would instead treat all properties,

be they flats or houses, as a "residential unit", with enfranchisement rights afforded to such units dependent on their nature and make-up.

Accordingly, a stand-alone individual property, which might currently be considered a "house" would qualify for an individual freehold claim, with the current age-old problem of having to determine if such a property in mixed-use is a "house" removed by simply setting a limit on the extent of the non-residential use. That limit is proposed to be set at 50%, partly to provide consistency with the limit set for collective claims, but partly to ensure that tenants of an individual property in mixed-use are not, in fact, deprived of rights they might currently enjoy.

It is worth noting here that this is a good illustration of the need for an integrated approach to all reform as a whole, rather than the current habit of cherry-picking individual aspects. Presumably, the thinking behind the introduction of such a 50% limit pre-supposes that the Government will look to implement the introduction of the concept of all properties being treated as a "residential unit", but to date there has been no definitive announcement to that effect. Similarly, within the recommendations in the Commission's report was reference to there being a clearer definition of business premises which would not qualify for enfranchisement rights. It would seem sensible to address that question as part and parcel of the extent to which non-residential use would preclude a claim, and yet there is no mention of that here

There is much to commend the idea of finally providing, by way of an absolute limit, practitioners and their clients with certainty as to whether a particular individual property in mixed use might qualify for a freehold claim. However, the obvious question is whether 50% is the right limit.

Whilst the trend in caselaw has been towards opening up the availability of such rights to mixed-use properties in greater non-residential use, it is far from the case that a property in 50% commercial use could be said to be a "house". Once again, setting such a limit will increase the number of buildings to which rights to claim the freehold apply. Once again, claimant tenants are, presumably, unlikely to object, and, once again, it is not difficult to see that landlords will.

Perhaps even more pronounced than in the case of buildings qualifying for a collective claim, setting the non-residential limit at 50% in the context of an individual freehold claim, results in many properties qualifying that will feel far-removed from the concept of the tenant's residential home.

In addition, the notion of arriving at a 50% limit in this context so as to mirror the limit set for collective claims seems unnecessarily simplistic. There is no reason why the two could not differ - practitioners and their clients could apply the test equally well if the limit for an individual freehold claim were set, for example, at 80%, regardless of the fact that that percentage might differ from that applicable to collective claims.

Set against this background, it seems that there is a greater likelihood of landlords challenging the introduction of these measures (and here this might equally apply to the setting of a non-residential limit of 50% in both collective and individual freehold claims), possibly under Human Rights legislation.

Introducing mandatory leasebacks in collective enfranchisement claims

When a group of tenants make a collective claim for the freehold of their building, there is very often a division between a majority who participate in that claim and a minority who do not participate. Under the current law, the participating tenants acquire the freehold of the whole building and pay for the value of that whole building, including the landlord's reversionary value in the non-participants' flats.

The consultation proposes the introduction of a new measure, which would entitle the participating tenants to require the landlord to take leasebacks of the non-participating tenants' flats. The idea behind this is that, in so doing, the price payable for the freehold will be reduced, because the participating tenants are not paying for the inherent value in the non-participants' flats (with such value being retained in the leasebacks held by the landlord).

It is difficult to know whether a group of claimant tenants would take up this option if it were available. At face value,

it might hold some attraction to those claimants, if it serves to reduce the price payable for the freehold. However, it also creates a more complex, and potentially messy title structure. Currently, if the claimant tenants acquire the freehold, they take the freehold of the whole building (usually through a nominated company) and become the direct landlord of the occupational tenants (be they the participating tenants or the non-participating tenants). In effect, the title structure is preserved, but with the claimants' company taking the role of freeholder and landlord to the occupational tenants in place of the previous freeholder.

If, instead, the previous freeholder is granted leasebacks of some of the flats, a new title "layer" is created for those flats. The claimants' nominee company is the direct landlord of the occupational tenants of those who participated in the claim, but when it comes to the non-participants' flats, the old freeholder is a headlessee, with an intermediate interest between the new freeholder and the occupational tenants of those flats. That has the potential for management issues.

Similarly, from the perspective of the landlord being required to take leasebacks, the proposed reform would result in that landlord being forced to accept an interest in this building (ie. a lease of a single individual flat) and the role of a landlord to an occupational tenant of a single individual flat. That is inherently different to the type of interest (of a whole building, providing the ability to manage that building as a whole) which it first chose to acquire.

Given this last point, there is every chance that, once again, landlords will raise objections. However, the Government may need to consider a wider political aspect to the proposals relating to collective claims. The introduction of mandatory leasebacks, or probably more likely the increase in the non-residential limit to 50%, runs the risk of companies deciding to cease investing in large-scale mixed-use urban regeneration. For any serious investor, these measures will be seen as increasing the risk, diminishing its control over a building and making it more difficult to manage properties for the long term. At a time when the Government has committed to raising housing numbers, it needs to consider the potential for creating a disincentive for development of a critical part of the market which might deliver that additional housing.

One final note as to the format of the consultation. As mentioned above, there is a sense that the Government may have already made up its mind as to the outcome of this exercise. However, what is also of concern is the approach to the structure of the questions to which answers are sought. Many are framed along the lines of "yes/no/don't know". Any of us familiar with the field of enfranchisement legislation will be well aware that there are few, if any, aspects which lend themselves to a one word answer. If the Government is truly committed to an open-minded consultation, it needs to afford all respondents, on both sides, an opportunity to expand on their replies, and give proper weight and consideration to what will undoubtedly be nuanced answers.

The consultation invites replies, and runs until 22 February 2022.

Written by

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