The Law Commission's 13th Programme of Law Reform

THE LEASEHOLD REFORM ACT 1967 ("the 1967 Act")
THE HOUSING ACT 1974 ("the 1974 Act")
THE LEASEHOLD REFORM, HOUSING AND URBAN DEVELOPMENT ACT 1993 ("the 1993 Act")
THE HOUSING ACT 1996 ("the 1996 Act")
COMMONHOLD AND LEASEHOLD REFORM ACT 2002 ("the 2002 Act")
HOUSING AND PLANNING ACT 2008 ("the 2008 Act")

Purpose

1. The purpose of this paper is to demonstrate that leasehold enfranchisement is a topic that should be considered as a law reform priority, either in itself or as part of a wider review of residential leasehold law.

Leasehold Enfranchisement

2. The term "leasehold enfranchisement" has for many years been used to describe the principle that leaseholders should be enabled to become freeholders by the compulsory purchase of the fee simple of their holdings. More recently, the expression has been expanded to encompass the general statutory rights now given to leaseholders to acquire superior interests and/or to acquire an extended lease.

3. The issue of leasehold enfranchisement has been a topic of debate going back to Victorian times. However, before the 1967 Act there were no statutes of a general nature which gave enfranchisement rights. The 1967 Act has now been with us for nearly 50 years. Originally intended to allow enfranchisement of lower rateable value houses, it was amended significantly by the 1974 Act (which introduced higher rateable value limits and allowed for marriage value in the valuation formula), again by the 1993 Act (which removed rateable value limits altogether), then by the 1996 Act (which removed the low rent test in respect of leases for a term in excess of 35 years), then by the 2002 Act (which further limited the circumstances where the low rent test applied and, in most cases, the residence test, as well as removing marriage value for leases with over 80 years unexpired) and finally by the 2008 Act (which further modified the low rent test by abolishing it almost entirely for "new" leases). The 1993 Act introduced for flat owners with qualifying leases the collective right to enfranchise blocks of flats and the individual right to a lease extension. It was also substantially amended by the 1996 Act and again by the 2002 Act.

4. The principal purpose behind all this amending legislation was to try to make the enfranchisement process easier by reducing the qualification rules and simplifying the valuation process. Whether it succeeded is a moot point. The 2002 Act also attempted to make a collective claim fairer by giving all tenants the opportunity to participate in a claim through the mechanism of a Right to Enfranchise Company; however, those amendments have never been brought into effect because they are unworkable.

Criticisms - general

5. The legislation has been the subject of much criticism. This criticism can be divided into three main areas, although clearly they are each inter-linked.

6. First, there is the objection in principle to the whole concept of leasehold enfranchisement. It has to be said, however, that this element of the debate is now at an end—it is principally a political issue and there is a clear consensus between the political parties that the concept of leasehold enfranchisement is here to stay. Furthermore, the principle of leasehold enfranchisement is generally accepted by landlords and tenants alike; the current focus should be therefore on making the system effective and fit for purpose.

7. Secondly, there is the criticism of the political process by which this legislation was passed. The 1967 Act itself was passed on the basis of a political consensus on the need for leasehold reform. Although the product of a Labour Government, the Conservative opposition objected to the Bill, not on the principle, but on the provisions for compensation, which they considered, were "confiscatory". The 1974 Act was very different and the history of its passage through Parliament makes sorry reading indeed. Little it seems was learnt from that experience in relation to the 1993 Act, the 1996 Act and the 2002 Act, each of which was a sad reflection on the parliamentary process. It is a classic example of "tinkering" with legislation; introducing a raft of amendments (some technical and some substantive), very often leading to "unintended consequences".

8. The third area of criticism derives from the second area and relates to the contents of the several Acts. If there is legislation that is politically controversial, ill thought-out, often debated by people who have minimal understanding of the subject and very often drafted "on the hoof", it is hardly surprising that it is full of errors, omissions and anomalies. Some of these errors, omissions and anomalies are within the individual Acts, whereas some relate to the

cross relationship between the Acts.

Criticisms – specific

9. There follows a summary of some of the criticisms that can be made of the legislation. It deals principally with the legislation as it stands; it does not seek to deal with some of the more fundamental issues of leasehold reform such as whether there is still a role for the extended lease under the 1967 Act (and if so, is it now fit for purpose); whether the statutory valuation should include marriage value; whether deferment rates or relativity should be prescribed; the relationship between the courts and the tribunals as the forums for resolving disputes etc.

(1) *Qualification rules*

(a) Perhaps most strangely and despite four visits to the House of Lords and one (so far) to the Supreme Court (and numerous visits to the Court of Appeal) on the subject, there still remains considerable doubt as to the meaning of "house" in section 2 of the 1967 Act. This is a particularly good example of "unintended consequences"; no thought was given to the impact on the statutory definition of "house" by the removal of the residence test as a condition of enfranchisement.

(b) The 1993 Act contains no provisions currently in force regulating the relationship between the tenants of a building that qualifies for collective enfranchisement. The reason for that is that the provisions relating to a RTE company still sitting in the 2002 Act are unworkable in their present form. These provisions should either be made workable or repealed.

(c) Low rent. It is accepted that the circumstances where a low rent test still exists are now very limited. Nevertheless, in so far as it still applies to houses under the 1967 Act, there are criticisms that can be made. There are for example alternative tests depending on when the lease was granted and each test contains a number of different rules and conditions. Part of these tests depends on historic rateable values which can now often be very difficult to obtain. It is suggested that where there remains a need for a low rent test (is there?), there should be one simple test.

(d) Long tenancies:

(i) The definition of tenancy is not the same in the 1967 Act as in the 1993 Act. There does not appear to be any logical reason for this and it causes particular difficulties where sections have been added to the 1967 Act by the 1993 Act.

(ii) In relation to long tenancies, although both the 1967 Act and the 1993 Act contain broadly similar provisions concerning statutory extensions, renewal tenancies and concurrent tenancies, only the 1967 Act allows consecutive long tenancies to be joined. There is no obvious reason for this differential.

(2) *Procedure*

(a) The 1967 Act has prescribed forms for a claim whereas the 1993 Act does not. The validity of notices given and received remains a fertile area for litigation. There is no reason not to prescribe forms of notice for the 1993 Act.

(b) The 1993 Act includes provisions for the service of information notices. There are no such provisions in the 1967 Act.

(c) The 1993 Act requires the claimant to state an offer price both for a lease extension claim and a collective enfranchisement claim and for the counter-notice to state the landlord's counter-offer. There is no such requirement for a claim under the 1967 Act.

(d) In the case of a lease being forfeit, leave of the court is required to serve a notice of claim under the 1993 Act but not under the 1967 Act.

(e) Failure by the landlord to serve a counter-notice within the prescribed time-limit under the 1967 Act has no particular consequences, despite being in a prescribed form. It potentially has very severe consequences for the landlord in a new lease or collective claim. Furthermore, the counter-notice in a collective claim is required to state whether the premises are within an area of a 1993 Act scheme but not

whether they are within the area of a 1967 Act scheme.

(f) Time-limits generally under the 1993 Act are strict, whereas under the 1967 Act that is not the case. The 1993 Act time-limits are a minefield for those not entirely familiar with the legislation and produce more fertile ground for litigation. It has never been obvious why the legislative schemes under the two Acts should be so different.

(g) The deposit on a house claim is payable at any time after the claim notice has been served and is calculated by reference to the ground rent reserved by the lease on which the claim is based. It can be paid as either agent or stakeholder, at the option of the landlord. Following general abolition of the low rent test, the "ground rent" may now be a high figure giving rise to payment of a very substantial deposit. The deposit on a new lease claim is payable at any time after the claim notice has been served and is calculated by reference to the premium offered by the tenant. It must be paid as stakeholder. The deposit on a collective enfranchisement claim is not payable at all until a contract is entered into following determination of the full terms of acquisition.

(h) The 1993 Act (as amended) includes provisions for the landlord to obtain access to the property for any purpose "arising out of the claim". There are no such provisions in the 1967 Act.

(i) If a collective enfranchisement claim is not admitted, it is the nominee purchaser who must then make an application to the court within a period of two months—otherwise his claim is deemed withdrawn. If a lease extension claim is not admitted, it is the landlord who must make the application in order to sustain his negative counter-notice. There is no discernible logic for this.

(j) Failure by the nominee purchaser in a collective enfranchisement claim to comply with a statutory notice to deduce title can lead to the claim being deemed withdrawn. There is no such penalty in a claim for a new lease. The whole issue of "deduction of title" should be reviewed in light of the universal compulsory registration of title and open registration of titles.

(k) The default procedures under the 1967 Act and the 1993 Act are generally different. Broadly, under the 1967 Act default is dealt with by service of a default notice under the regulations whereas under the 1993 Act, default is dealt with either by "deemed withdrawal" or by the court, after service of a default notice. The completion procedure for a new lease claim under the 1993 Act is cumbersome and unclear

(l) The 1993 Act makes it obligatory for the parties to make an application to the First-tier Tribunal if agreement on terms has not been reached by a certain date (with draconian consequences for failure) —there is no such compulsion under the 1967 Act.

(m) The procedure for leasebacks under Schedule 9 to the 1993 Act is far from clear, despite some judicial guidance. It seems to suggest (but it is still not entirely clear) that the landlord can call for a leaseback on a qualifying unit at any time before completion of the transfer of the freehold to the nominee purchaser. However, there is no provision to adjust the price or other acquisition terms if the landlord elects to take his leaseback after those terms have been agreed or determined.

(3) *Valuation*

(a) Notwithstanding the fact that it has long been established that the 1967 Act can apply to buildings in multiple occupation which may now in addition be subject to rights under the 1993 Act, this appears entirely to have escaped the draftsman of the valuation provisions in the respective Acts. A valuation under section 9 of the 1967 Act assumes that the tenant has no rights to acquire the freehold under that Act which accords with compulsory purchase principles. However, in addition to the 1967 Act rights that are ignored, the claimant might well have rights to participate in a collective claim or to claim a statutory lease extension under the 1993 Act. Indeed, in such an event, such rights are likely to be valuable if his rights under the 1967 Act have to be disregarded. Similarly, in the case of a collective enfranchisement or lease extension claim under the 1993 Act, there is a similar assumption as regards rights under the 1993 Act but no disregard for rights that an occupying headlessee might have under the 1967 Act.

(b) The 1967 Act contains three/four different valuation formulae for house claims dependent on a combination of arbitrary qualifying conditions. Although two/three of the formulae (sections 9(1A), 9(1C) and 91AA)) are very similar and thereby have a degree of consistency, the other formula (section 9(1)) is entirely different (and wholly inequitable to the landlord).

(i) In some cases, a house, otherwise falling within the original 1967 Act qualifying criteria, has a rateable value of over £1,000 in Greater London or £500 elsewhere. In such a case, the freehold must be valued under section 9(1A), although it must be doubtful if that was intended. Similarly, a house that otherwise falls within the original 1967 Act qualifying criteria but for the fact that it is just over the low rent limit under the 1967 Act and also has rateable value less than £1,000 in Greater London or £500 elsewhere will nevertheless be valued under section 9(1C).

(ii) The valuation is to be made on the assumption that the tenant has the right to remain in possession of the house and premises under the provisions of Part I of the Landlord and Tenant Act 1954 or under Schedule 10 to the Local Government and Housing Act 1989. Some tenancies are in fact within the protection of Part II of the 1954 Act. Furthermore, the rules for qualification under the 1954 Act and the 1989 Act are not the same as the rules for qualification under the 1967 Act and it is therefore possible to have a tenancy valued on the assumption that rights under Part I or Schedule 10 exist where in reality they do not.

(iii) The provisions regarding tenant's repairs under section 9(1A) are illogical, and lead to the absurd conclusion that a tenant who in breach of covenant allows his house to fall into disrepair pays less for his freehold than a tenant who maintains his house in proper repair.

(iv) A valuation under section 9(1C) allows the landlord to seek payment of compensation under section 9A, but not if the valuation is under either section 9(1) or section 9(1A). It is hard to find any realistic justification for

this.

(c) At least under the 1993 Act, there is a single valuation formula each for collective enfranchisement and for the new lease claim. However, even these formulae are not without their difficulties:

(i) The definition of marriage value in Schedule 6 to the 1993 Act has been heavily criticised, not least for its lack of clarity. It was even been suggested at one time that the definition is entirely flawed, although this has never been accepted by tribunals

(ii) There has been a degree of controversy over the question of whether or not the statutory disregards apply to the valuation of the leaseholder's interest as well as to the valuation of the freeholder's current interest. Tribunals (upheld by the courts) have applied the disregards at all stages of the valuation under the 1967 Act (where they apply). However, the position is still not entirely clear in respect of a collective enfranchisement valuation; the Court of Appeal held that the disregards applied at all stages but permission to appeal to the Supreme Court on the point was given but not pursued.

(iii) The basis on which an intermediate landlord is compensated under the 1993 Act is flawed. The use of the "formula" in relation to the determination of the amount to be paid to the intermediate landlord where the intermediate lease is a minor intermediate lease is virtually unworkable, given that the formula is designed to ascertain a price and not a value. Where the formula is applied under the 1967 Act, the amount determined by it is the whole price; under the 1993 Act, the intermediate landlord receives in addition a proportion of marriage value. It is questionable whether having a separate valuation formula for minor intermediate leasehold interests (which in practice is rarely, if ever, used by valuers) really serves any useful purpose. In any event, the formula is presently unworkable following the redemption of 2.5% Consols, the yield from which is part of the formula.

(iv) The combined effects of Schedules 6, 11 and 13 of the 1993 Act potentially produce a wholly inequitable result for a freeholder who is faced with a two-stage enfranchisement claim—individual new lease claims followed by a collective claim. The unfairness arises because at the second stage (collective enfranchisement) the valuations are carried out without reference to the valuations carried out and the amounts paid at the first stage (individual new lease claims).

(4) *Housing Act 1974 Schedule 8*

Considerable and justifiable criticism has been made of the provisions of Schedule 8 to the Housing Act 1974. As in the case of section 9(1A) of the 1967 Act, some of the uncertainties have subsequently been resolved by judicial decision. Furthermore, with the abolition of the rateable value limits for a freehold claim under the 1967 Act, the opportunities to use Schedule 8 are likely to be less. Nevertheless, it retains a particular role in offering some tenants an opportunity to take advantage of the more favourable valuation formula under section 9(1) (where the price differential can be substantial) and it is appropriate therefore to set out the relevant criticisms that remain:

(a) the tenant's improvements that are within the Schedule include improvements made in pursuance of an obligation to the landlord (and may even include the house itself if constructed pursuant to a building lease);

(b) the Schedule includes unduly strict time-limits that are a trap for the unwary;

(c) the Schedule fails to provide for a notional reduction in respect of tenant's improvements made after April 1, 1973, bearing in mind particularly that the relevant date for determining whether or not a house comes within the rateable value limit for a valuation under section 9(1) is now March 31, 1990;

(d) the Schedule provides only for a certificate from the valuation officer to specify the notional reduction only on April 1, 1973 whereas the relevant date under section 9(1A) is now March 31, 1990;

(e) the procedural provisions of the Schedule are unsatisfactory in failing:

(i) to require the landlord to serve a notice in reply to the tenant's notice claiming a notional reduction;

(ii) to require the tenant to deliver to the landlord a copy of his application to the Valuation Officer; or

(iii) to deal with sub-tenancies;

(f) There is no provision for an appeal from the Valuation Officer's decision.

(5) *Commercial property*

(a) A building does not qualify for collective enfranchisement under the 1993 Act if more than 25 per cent of the internal floor area has non-residential use. A tenant cannot be a qualifying tenant under the 1993 Act for the purpose of either a collective enfranchisement claim or a new lease claim if he has a business tenancy. Prior to the 2002 Act, there were no such restrictions in the 1967 Act. The position now under the 1967 Act is that if the tenancy is a business tenancy for an original term of 35 years or less, the tenant has no rights under the Act; if it is for an original term of more than 35 years, then the tenant must fulfil a residence test. The question as to whether the tenancy is a business tenancy is based on the nature of the tenancy rather than the use to which the building is put, so it is not a difficult requirement to circumvent.

(b) It remains an area of considerable uncertainty as to the extent to which a building in commercial (or part commercial) use under the 1967 Act is a "house" within the meaning of section 2. Thought needs to be given as to whether the definition of "house" should be reconsidered in the context of (i) properties with some element of commercial use and (ii) buildings comprising flats which may have rights under both the 1967 Act and the 1993 Act

(c) In a collective enfranchisement claim under the 1993 Act, the landlord has the

option of a leaseback on commercial units; there is no such option following a claim under the 1967 Act on mixed-user buildings.

(6) *Right to Enfranchise (RTE) Company*

No discussion entitled "criticisms" would be complete without some comment on the most recent example of inadequate legislation. Although derived from the best of intentions of wanting to ensure that all those who wish to participate in a collective claim should have the right to do so, the provisions relating to RTE companies and the procedure to be associated with them will unquestionably make a claim more difficult. This arises from two principal factors. First, there will be even greater opportunity for argument between participators and in particular the terms on which participators will be invited to join in. Secondly, the procedural requirements will be much more complex by requiring the participating group to go through a number of further preliminary stages before a claim can be made. It is fair to say that these provisions have not been brought into force and the government has said that it has no present intention to bring them into force. However, the sections remain on the statute book and until they are repealed they should be critically examined. Some of the more obvious criticisms are:

(a) There are no deemed service provisions for the "notice of invitation to participate" so that actual service will need to be proved in each case; a potentially enormous difficulty in the case of a large block where many of the leaseholders may live abroad. Every person entitled to be served with an invitation notice must be given it before the claim can be made.

(b) The invitation notice must contain an estimate of the price for the freehold, but no sensible estimate can be given until the number of participators is known.

(c) There is a saving provision to the effect that an invitation notice will not be invalidated by any inaccuracy in any of the "particulars" required by the section. There are no such "particulars".

(d) There is a rather curious provision that an invitation notice will be treated as not having been given if a person is not allowed to inspect or obtain a copy of the

memorandum and articles of association of the RTE company as specified in the notice. It is unusual insofar as the provision seeks to invalidate a notice by circumstances arising after the date that the notice is otherwise validly given.

(e) Because there are no provisions which regulate the terms on which a qualifying tenant is to be invited to participate, it is anticipated that considerable argument will arise as to whether or not an invitation notice is invalidated because it does not set out "realistic and genuine terms" if a qualifying tenant feels that the terms on which he has been invited to participate are "not fair".

(f) It seems to have been overlooked by the draftsman that it is quite possible that a landlord (particularly in a large block) may own one or more flats in the building (say, through an associated company) and thereby be a qualifying tenant himself. In such circumstances, he will be required to be served with an invitation notice and thereby become aware of the tenant's negotiating position even before the claim notice is given.

In the light of these criticisms, it was always hard to see how the Government could ever have believed that the introduction of the RTE provisions would, as they stated at the time, "make enfranchisement of flats easier". Arguably, they might make it fairer, to the extent that a tenant who wants to participate cannot on the face of it be left out, but at the undoubted expense of making an already complicated procedure very much more so.

Criticisms – comments

10. There are numerous other examples of errors, omissions and anomalies within this legislation. The courts continue to be called upon to assist the legislators to try to resolve these difficulties; in that context it is worth noting some of the comments that have made by them about this legislation.

11. In the second edition of *Hague on Leasehold Enfranchisement* published in 1986 and edited by Nigel Hague QC (as he then was), he said this: "*Both Section 9(1A) of the 1967 Act ……. and Schedule 8 to the Housing Act 1974 are a disgrace to the statute-book. The blame must be shared equally between the politicians concerned and the draftsmen advising them, all of*

whom meddled irresponsibly in areas beyond their comprehension and skills."

12. In *Cadogan v Sportelli* [2008] UKHL 71 Lord Neuberger said: *"The original drafting of at least parts of Chapter 1 of Part 1 of the 1993 Act left much to be desired, and subsequent amendments have in some cases made things worse"* and then went on to describe the drafting of the 1993 Act as *"inept".*

13. In *Hosebay v Day* [2010] EWCA Civ 748 Lord Neuberger MR (as he then was) said: *"I rather doubt that the amendments made to section 1* (of the 1967 Act) *in 2002 and, in particular, the removal of the residence requirement, were intended by the legislature to have this sort of effect. Significant amendments to statutes often provide good instances of the law of unintended consequences, and this may well be an example. However, the issue that we have to decide is not what we think the legislature would have said had it fully appreciated the consequences of the primary amendment it made to the 1967 Act (removal of the residence requirement), but what we think that the Act means in the light of that amendment."*

Enfranchisement – the arguments

14. The difficulties associated with this legislation have existed for decades. Residential leasehold law is a politically charged subject and tends to receive attention only in response to campaigns. Although many of the problems give rise to arguments over the perceived unfairness and inequity of the leasehold system, it has to be accepted that the system is likely to be here to stay for the foreseeable future. Many of the issues are debated in the context of the conflict between "wicked" landlords who are said to see property simply as in investment to be exploited and "downtrodden" tenants whose homes are the subject of that exploitation. Of course, it is not quite as simple as that. Whilst this analysis is undoubtedly true in some circumstances, the residential leasehold sector is much more complicated than that, particularly with the rise of substantial off-shore investment in UK property (particularly in central London) and the increase in the private rented sector.

15. Attempts by government over many years to introduce an alternative system of land ownership either to work alongside or to replace the leasehold system has been wholly unsuccessful. The Commonhold and Leasehold Reform Act 2002 was the culmination of a

succession of consultations, Law Commission Reports, White Papers, draft Bills etc suggesting and promoting alternative land ownership schemes. However, the introduction of commonhold in 2002 can only be described as an abject failure. The take up has been minimal and, notwithstanding a number of rather half-hearted attempts since 2002 to breathe some fresh air into the commonhold balloon, it has singularly failed to rise up from the ground.

16. Flats continue to be built and will form an essential part of the provision of future new housing in the England and Wales. Those flats will generally be sold and a lease will be the instrument of sale. Far from a reduction in leases therefore, we can expect to see a considerable increase in the number of properties held on a lease.

17. The perceived disadvantages of the leasehold system can be divided into two broad categories: management and the wasting asset. As regards management, the government initially sought to alleviate scope for the exploitation of tenants from service charge abuses and management failures by providing a statutory framework of regulation of service charges; principally the Landlord & Tenant Acts 1985 and 1987. The latter statute also gave tenants certain rights to take over management by appointing a receiver and/or acquiring the landlord's interest in the event of default. This approach was subsequently extended by giving tenants an ability to acquire a no-default Right to Manage under the 2002 Act. As regards the wasting asset, tenants were given the statutory right to acquire either a freehold or a longer lease on "fair" terms subject to fulfilling various conditions (the 1967 Act and the 1993 Act). Those conditions have been modified over the years to allow an increasing number of lessees (not just home owners) to exercise these rights. What started out as a right primarily for "home owners" to buy their freehold or extend their lease has now become pretty much a universal right for all residential leaseholders.

Conclusion

18. There is no likelihood in the immediate future that the leasehold system will wither or die and, without an acceptable alternative (and commonhold is clearly not it), the number of residential leaseholds is likely substantially to increase in the years to come. It is therefore essential that the law relating to residential leasehold should be the subject of a review. If it is here to stay, it needs to be fit for purpose. Others will no doubt be making representations on other aspects of residential leasehold law, particularly on issues relating to management

and the regulation of service charges. The purpose of this paper is to urge the Commission to include, in any review of residential leasehold law, those statutes which deal with leasehold enfranchisement.

19. It is accepted that the argument over whether or not tenants should have rights of enfranchisement is long-since settled. The issue now is whether, given the increasing number of new properties that will be sold using the leasehold system, the current legislation gives effective and efficient rights to tenants whilst maintaining a balance of fairness between the interest of both landlords and tenants. This paper sets out a number of criticisms of the legislation which should properly be considered for reform. However, it goes wider than that and any review should not just look at technical amendments to address the criticisms but should also consider whether (for example) the provisions of the 1967 Act and the 1993 Act could be merged to provide a single statute for universal rights of enfranchisement, covering all residential property, with a single procedure and a single universal valuation principle. At the very least, this legislation needs to be consolidated to provide a universal scheme for residential tenants to be able to enhance their interests on fair terms.

27th October 2016

Damian Greenish