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Tackling unfair practices in the leasehold market

Introduction

The City of London Law Society (“CLLS”) represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

A full list of the CLLS corporate members may be found on the CLLS website at http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=81&Itemid=468

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response is in respect of the Department for Communities and Local Government’s Consultation on “Tackling unfair practices in the leasehold market.”

The Committee responds to the Consultation using the paragraph numbering adopted in the Consultation.

Paragraph 3

There has been public concern about some instances of excessive ground rents being charged and the possible conversion of valuable long leases to assured tenancies. That concern does not justify a possible approach of prohibiting most new build houses from being leasehold. To effect such a change potentially could have a significant impact on the property market. At a time when there is the need for a supply of new housing stock, the Government should think carefully before making structural changes to the market that could have unintended consequences. In addition, the current law around the enforcement of positive obligations (e.g. to pay a service charge) does not provide an adequate framework to support such change.

The consultation paper provides little evidence that it has investigated the potential impact of such a change on the market and whether it would discourage private sector investment in the development of new housing stock (which it is seeking to encourage). It is important that the Government commissions valuation and market surveys to understand the implications of such a change before it is effected.

On a similar point, at paragraph 3.5 reference is made to it not being clear that the “leasehold discount” is always passed on to the consumer, at paragraph 3.8 to this representing poor value for consumers and at paragraph 3.12 to it not always being clear that the initial discount on the sale price of a leasehold house reflects the additional medium to long term costs that leaseholders may face. The alleged lack of return or value for leaseholders from ground rents is also referred to in paragraph 4.2. No evidence is provided for these statements and, in view of the significance of the proposals, this requires further analysis and evidence, which can be presented to the property and house building industries.

In paragraph 3.6, reference is made to the argument that selling a freehold house could create a potential competitive disadvantage, but this is not elaborated on further.

There are conveyancing advantages to the use of a lease, in particular in relation to the enforcement of covenants (obligations under a deed) between successor landlords and tenants. As the law currently stands, freehold tenure is more cumbersome for the enforcement of the benefit and burden of “positive covenants” by and against successors. The Law Commission’s consultation on “Easements, Covenants and Profits a prendre” https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/03/lc327_easements_report.pdf highlighted the issue and proposed new mechanisms to overcome the problems. However, the proposed legislation has still to be enacted. Commonhold in its current form is a somewhat unwieldy procedure and has rarely been used.

Having an effective and flexible mechanism (as is provided by leases) for covenant enforcement between landlords and tenants is a relevant and important reason for

new build houses having a leasehold tenure. There may be shared services or facilities for example where the house forms part of a larger building, or in relation to estates of detached houses with communal areas and services (which require service charge provisions) and the advantages of leases mentioned should not be dismissed by a broad-brushed approach of preventing new-build houses from having leasehold tenure.

It would be preferable to focus on the particular mischiefs creating the alleged unfair and unreasonable abuse of leasehold, which are addressed elsewhere in the paper and in the Committee's response.

A key theme that emerges from the section on "Impact on consumers" (paragraphs 3.11-3.14) is that the consumer does not properly understand the implications of taking a lease. The Government and stakeholder groups in recent years have made efforts to produce general information that assists consumers to understand better what they are entering into. This educational campaign should be extended and coordinated between Government and stakeholder groups. The lack of proper explanation to consumers, whilst extremely regrettable, does not justify restrictions on new-build houses being leases. The mischiefs that are highlighted in paragraph 3.12 can be addressed separately without the need for such restrictions. Consideration can be given to the ways in which fees for landlord's permission to make alterations or the provision of a covenant can be controlled in a new-build house context. This is something that can be covered in the further steps envisaged under paragraph 7 of this consultation. There is existing legislation for ascertaining the cost of extending a lease or buying the freehold and more evidence is required that the mechanisms are not fit for purpose. It seems that the problems are caused by the high level of ground rent and this is addressed in the Committee's response to other parts of the paper.

In relation to paragraph 3.13, the Committee agrees that consumers should be informed that their landlord has changed, although it is in the interests of the new landlord (for both legal and practical reasons) to ensure that the consumer is informed.

In summary, the Committee acknowledges that there clearly are problems with the current system that need addressing and are mentioned in the rest of the paper and in the Committee's response. However, the Committee is not convinced that the broad-brushed approach of prohibiting new-build leasehold houses in most situations is a sufficiently precise method of addressing the concerns, certainly in the absence of further investigations and empirical evidence. The continued availability of a reasonable and transparent ground rent in leases that is moderately increased over time is a potentially important incentive for developers of new-build housing and to prevent this could have negative consequences for the development of new housing and the property industry more generally. The irony is that in seeking to protect consumers, they may be adversely impacted through a more constrained housing supply resulting from the impact of any legislative change. All of this needs testing through further investigations. It is also important to consider the attitudes and policies of lenders to financing the purchase of new-build housing and their requirements, if any, for a minimum length of term of lease, as for example reflected in the UK Finance Mortgage Lenders' Handbook for conveyancers.

Paragraph 4

The Committee considers that the Government needs clearer evidence that leaseholders receive no return or value for the ground rent and in relation to whether any reduction in the price for buying a long leasehold as compared to a freehold adequately reflects the ground rent that the purchaser of the leasehold will pay.

There is no dispute that in some cases escalating ground rents have been onerous, unsustainable and severely detrimental to consumers and it is agreed that such onerous examples should be addressed. An important part of the issue is the lack of transparency and awareness about the impact of the lease wording in relation to ground rents, both in terms of the amount payable and the implications on the cost of extending the lease or purchasing the freehold.

One possible solution might be to link the initial ground rent to the price paid for the leasehold by the consumer so that the ground rent cannot exceed a prescribed percentage of the price paid. It would be sensible for the Government to pay close attention to the requirements of lenders to purchasers of residential leasehold property and what limits they impose on ground rents. In terms of increases to the ground rent over the term, it may be appropriate to link increases to increases in a Government recognised index such as the retail prices index with longer review periods. The Committee considers that the suggestion at paragraph 4.17 to limit ground rents in new leases to start and remain at a peppercorn is not appropriate. The Committee considers that a moderate ground rent, perhaps linked to the initial price for purchasing the lease, and moderately increased over the term will not cause undue prejudice to consumers, but equally is likely not to disincentivise investors in new housing. As stated earlier, these statements need to be tested through thorough studies and investigations by valuation experts to understand fully the implications on the market of any proposed measures.

The Committee notes the reference to the right of first refusal at paragraph 4.14 and struggles to see the connection to the ground rents concern. If it is considered that changes need to be made to the relevant legislation relating to the right of first refusal, the Government will presumably consult separately on this.

The heading of paragraph 4 refers to new residential leases over 21 years. However, there is no reference to 21 years in the questions for this paragraph. Perhaps the term should be the same as that referred to in the Committee's comments on paragraph 5.

Paragraph 5

The Committee very much agrees with the concern about long leases becoming assured tenancies as a result of the ground rent exceeding the £250/1,000 annual level. This is an unforeseen and unintended consequence of increasing ground rent levels over the years and it is inappropriate that the mandatory ground of possession

under ground 8 should apply to such long leases. For such leases, if there are arrears of rent, the tenant and its lender must have the opportunity to seek relief from forfeiture by the landlord and there are the existing statutory restrictions on forfeiture. Without this, the landlord would receive an unjustified windfall and the interests of consumers and their lenders would be severely prejudiced.

Question 19 asks whether the Housing Act 1988 should be amended to ensure a leaseholder paying annual ground rent over £250/1,000 is not classed as an assured tenant. Clearly assured shorthold tenancies (ASTs) are a species of assured tenancies and there may well be ASTs with a rent (admittedly not a ground rent) exceeding £250/1,000, which should continue to be assured tenancies and potentially subject to ground 8. The mischief relates to leases with a capital value being exposed to ground 8 mandatory possession and giving landlords a windfall. Consideration could perhaps be given to the amendment applying to leases granted for a term in excess of a particular period, which would generally be regarded as a “long lease” for which a tenant would pay an upfront capital sum/premium (perhaps such as for a term exceeding 21 years but a shorter period may be appropriate). Valuation advice should be sought from stakeholder bodies on what would be the appropriate length of term, although any choice of length of lease term should take account of other definitions of “long lease” in existing residential legislation.

Paragraph 6

The Committee agrees that the Government should promote solutions to provide freeholders of residential property equivalent rights to leaseholders to challenge the reasonableness of service charge for the maintenance of communal areas and facilities on a private estate. A leaseholder including a long leaseholder would have statutory protection and a freeholder, who may have paid a similar amount to a long leaseholder for their interest, should have equivalent protection. Reference is made to this applying to an “estate” and careful consideration should be given as to what this includes.

Yours faithfully

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Chair, City of London Land Law Committee

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