Tackling unfair practices in the leasehold market

Department of Communities and Local Government consultation
July 2017

September 2017

Tackling unfair practices in the leasehold market

Replies to consultation paper

Q1. Are you responding as:

On behalf of an organisation

Q2. If you are responding as a private individual, is your main interest as:

Not applicable

Q3. If you are responding on behalf of an organisation, is the interest of your organisation as (tick all that apply):

A solicitor / conveyancer

Q4. Please enter the first part of the postcode in England in which your activities (or your members' activities) are principally located (or specify areas in the box provided)

Birmingham and the wider West Midlands area

Q5. What steps should the government take to limit the sale of new build leasehold houses?

We do not believe there should be any further sales of leasehold houses other than for the prescribed set of restricted reasons listed in 3.2 of the consultation paper, which fundamentally relate to the freehold owner's special status and the preservation of the integrity of that status.

Expanding upon these exceptions, we believe that vis-à-vis 'restricted staircasing' leases that the rent review provisions should not contain a review (as the staircasing provisions will provide for the increase in capital value of the holding). Again, there should not be a rent review for leasehold property of special architectural or historic interest as the justification for the leasehold nature is to control matters by covenant and not financial controls.

If one of the above organisations disposes of a large tract of land by creating, either itself, or working with a developer, a large scale housing development, then we feel it can no longer be said to be holding on to the freehold reversion for heritage reasons and therefore should not be given an exception. The above organisations should not be allowed to grant leases to developers of estates of a certain size, for example over ten houses, as this would give the developers the excuse for granting underleases to the house buyers.

We also wish to add that the sales of leasehold property in Retirement Villages should be permitted provided that the event fees are subject to a "reasonableness" test with the ability to challenge the landlord's decisions through the First-Tier tribunals. 3.2 also lists 'cathedral precincts' as an exception, however this should be amended to 'cathedral or abbey precincts'.

Whilst there may not be anything inherently "wrong" with the leasehold system, the Government can and should step in where buyers are victims of unscrupulous practices.

Q6. What reasons are there that houses should be sold as leasehold other than under the exceptions set out in paragraph 3.2?

We do not believe there are any, however as alluded to in our response to Q5, from a developer's point of view, if they only have a leasehold interest, then they can only dispose of properties by way of underlease. This is important to note because if the disposal of new houses by lease is prohibited, a developer could try to circumvent the prohibition by taking a lease from the original landowner instead of acquiring the freehold.

Q7. Are any of the exceptions listed in 3.2 not justified? Please explain.

On National Trust or Crown Land (with suitable safeguards ensuring that Ground Rents shall not exceed £10-00 without review, this would ensure that the sale of the leasehold estate is not designed to create a financial instrument by way of the sale of the freehold reversion to a third party for valuable consideration.) National Trust property should be preserved for the Country's benefit but there could be changes such as 999 year leases with a peppercorn rent. This would make the difference of the land being still in the ownership of the National Trust but with a Lessee not having the restrictions of a "normal" lease. The same could apply for Cathedral precincts to preserve heritage.

There is no justification for land owned by local authorities or university bodies to be excluded as local authorities can use powers of compulsory acquisition if land is needed for development with the leasehold-owner having the right to challenge this through well-known and established processes. University bodies could use a right of Pre-emption or First Refusal to the same effect. In shared ownership with a restricted staircasing provision in the lease, the rent review provisions should not contain a review (as the staircasing provisions will provide for the increase in capital value of the holding) and this should also be the case in cases of special architectural or historic interest or adjoining properties where it is important in safeguarding them and their surroundings (again without rent review as the justification for the leasehold nature is to control matters by covenant and not financial controls). Were Her Majesty's Government (HMG) to legislate for positive covenants imposed on freehold land to run with the land, all of those special category cases could be deleted from the Leasehold Reform Act 1967 save for the restricted staircasing leases where the limit on escalating rent reviews should be imposed.

Finally, it can be the case with some of these exceptions that if a leaseholder wishes to purchase their freehold they are responsible for the Landlord's legal costs and given the unreasonableness of this, it is something we feel should be reviewed.

Q8. Would limiting the sale of new build leasehold houses affect the supply of new build homes? Please explain.

No. The house building market functioned for decades before the abuse created by the sale of new leasehold homes. There may be a PR effect on the builders.

A potential opposing argument is that leaseholds can be initially cheaper and that purchasers have an option to purchase the freehold after 2 years with the benefit of enfranchisement, or as a result of going to a Land Tribunal, however many purchasers do not want this hassle or inconvenience and indeed, the acquisition of a freehold from a leasehold can work out more expensive than if the said property had been sold freehold in the first instance.

Q9. Should the Government move towards removing support for the sale of new build leasehold houses through Help to Buy Equity Loan, unless leasehold can be justified and where ground rents are reasonable (which could be a nominal or peppercorn ground rent), and if not, why not?

Yes, as this would encourage developers to build more freehold homes and at the same time, it would encourage members of the Council of Mortgage Lenders to restrict their lending where abusive rent review terms are to be (or have been) created.

Further to the above, one of the Committee members suggested that the mortgage lenders (and possibly The Law Society) could assist in setting parameters and uniformity on what is and is not acceptable to lenders.

One Committee member did express concern that the possibility of HTB being removed for leasehold properties may make it harder for purchasers to afford a property as leasehold properties are usually cheaper than freehold (and there have been suggestions that developers may increase the prices of freeholds if they lose their leasehold revenue stream) but clients can lose sight that the HTB is essentially another loan which needs to be paid back as well as the first loan. The Committee would not like to see another 100% mortgage disaster.

Q10. In what circumstances do you consider that leasehold houses supported by Help to Buy Equity Loan could be justified?

The only circumstances HTB could be justified would be on properties built without an escalating ground rent (whether on private or publicly funded land).

Q11. Is there anything further the Government could do through Help to Buy Equity Loan to discourage the sale of leasehold houses?

No comment other than what has already been said in our responses above.

Q12. What measures, if any, should be considered to minimise the impact on the pipeline of existing developments?

We believe that the sale of leasehold new build properties should be prohibited (subject to the exceptions above) and the rendering unenforceable of any pre-sale of the freehold reversions to leases not granted at the date of the contract for such sale (or completion of the sale if earlier than the grant of the lease to which it relates). The effective date should be the date of the Prime Minister's statement to this effect in the House of Commons.

Leaseholders with current onerous leases may need to be compensated in some way with any new legislation but this is addressed in Q17.

The Government could increase the bottom band of Stamp Duty for new properties, especially for first time buyers.

Q13. What information can you provide on the prevalence of onerous ground rents?

This information is held by the Land Registry and can be retrieved by HMG. This data will be accurate and available to HMG.

Q14. What would a reasonable ground rent look like, in terms of i) the initial annual ground rent, ii) the maximum rate of increase in ground rent, and iii) how often the rate of increase could be applied to an annual ground rent? Please explain your reasons.

i) < £100.00 to maintain the "nominal" nature of the ground rent.
ii) Increase should not exceed 25% of the existing ground rent to ensure that the increase retains its "nominal" nature and does not become a financial burden / profit centre for the Freeholder.
iii) Should not exceed 4 increases throughout the term of the lease or every 25 years if less frequent. This would retain the nature of the increase regime considered appropriate in the 20th century, when increasing ground rents did not cause distress or financial hardship.

Q15. Should exemptions apply to Right to Buy, shared ownership or other leases? If so, please explain.

We believe that there should be no sale of houses under Right to Buy as leasehold unless the local authority does not own the freehold (when the local authority should sell for a term of 1 day less than the term held by the local authority. To grant a lease for the same term will act as an assignment of a portion of the local authority's term and create legal difficulties with the superior landowner as to apportionment of the ground rent.) Sales of flats and maisonettes under Right to Buy have hitherto been restricted from providing for Rent Reviews and this should continue with no review permitted. Likewise, shared ownership leases, whether the right to staircase out is restricted, should also not be permitted to contain any rent review provisions.

Q16. Would restrictions on ground rent levels affect the supply of new build homes? Please explain.

We do not think it should. The current trend for new build houses to be sold leasehold is merely a current tool to enhance the profitability of developers and house builders for the benefit of their shareholders to the detriment of their "customers" who require legal protection against the perceived "marketing benefits" of acquiring a property on leasehold terms. In some cases, buyers are more concerned about securing a "home" than considering the terms of the leasehold tenure and do not consider carefully the legal advice from their solicitors. In short, they need to be protected from themselves. Likewise, lawyers on the panel list provided by a developer / house builder cannot be perceived to be "independent" of the provider of the list, especially where referral fees are paid to the developer / house builder and this practice should be outlawed, especially where the new tenure will be leasehold (of any kind).

Q17. How could the Government support existing leaseholders with onerous ground rents?

HMG should legislate to declare that the rent review provisions contained in leases of residential properties for more than 21 years are unenforceable, both legally and in equity, thus reviews that have taken place will freeze the rent at the new level but no new increases will be permitted. If such clauses were to be declared void, then legally there would be a need to rewind any review previously undertaken and compensation would be payable.

Aside from ground rent provisions being altered in leases, legislation could force existing leases with onerous provisions to have a 999 year term and a peppercorn/ nominal rent. This would also reduce the financial incentives for developers. A more radical approach would be to have a perpetual ground lease, something introduced in Amsterdam in 2016 to tackle uncertainty over ground rent reviews.

An opposing argument is that the current leasehold owners bought their properties with the benefit of legal advice and should therefore reap the burden of the legal bargain into which they entered. Indeed it could be argued that taxpayers should not be responsible for a decision that has been made by a buyer who unfortunately did not heed advice from their solicitor/conveyancer when purchasing a leasehold property.

Q18. In addition to legislation what voluntary routes might exist for tackling ground rents in new leases?

With the financial benefit to the builder / developer of selling new build leasehold homes, it is not thought that a voluntary scheme would be effective as the fiscal benefit would outweigh the moral and social burden of the present scenario. Encouraging the Mortgage Lenders to restrict their activities in this area would be a powerful incentive for developers and house builders to re-consider their approach to this problem.

Q19. Should the Government amend the Housing Act 1988 (as amended by the Housing Act 1996) to ensure a leaseholder paying annual ground rent over £1,000 in London or over £250 in the rest of England is not classed as an assured tenant, and therefore cannot be issued with a Ground 8 mandatory possession order for ground rent arrears? If not, why not?

Yes, as the unintended consequence shows the unsatisfactory impact of the significant rent review provisions. The definition of an "Assured Tenant" should be amended to exclude "a person holding a leasehold interest who has acquired such interest by purchase"

One of the other dangers is that there is no provision for a mortgage lender to be advised of Ground 8 possession proceedings and nor is there is a provision (as with forfeiture) for relief to be granted if the rent paid (exceeding the amounts above) is paid after the hearing. This means that the tenancy can be terminated without the knowledge of the mortgage lender who will thus lose its security.

Q20. Should the Government promote solutions to provide freeholders equivalent rights to leaseholders to challenge the reasonableness of service charges for the maintenance of communal areas and facilities on a private estate? If not, what management arrangements on private estates should not apply?

Freeholders should be given the same rights as leaseholders to challenge management and service charges for the maintenance of communal facilities and areas. Likewise, if tenants residing in accommodation having the use of the same communal facilities and areas will suffer financial consequences of the implementation of such maintenance, then they too should be given like rights of consultation and challenge as both freeholders and leaseholders. The selling on of communal areas should be subject to right of first refusal to any residents' or tenants' management company.

It is worth pointing out that without service charges that there could be a bit of a "free for all" if some tenants refused to pay for maintenance and upkeep of a building. However, a commonhold system would be one solution with a not-for-profit managing agent in place – referred to in our suggestions for Q21.

Q21. The Housing White Paper highlights that the Government will consult on a range of measures to tackle abuse of leasehold. What further areas of leasehold reform should be prioritised and why?

Administration fees for Notices of Transfer, Deeds of Covenant and Certificates of Compliance should be looked at as this is something commonly abused by managing agents. Fees can and often run into hundreds of pounds for clients every time a leasehold property is bought or transferred. These fees can escalate when there is one set of fees to be provided to the Landlord and another to the managing agent.

We also believe that the current law that a positive covenant can bind a lessee but not the successor in title to a freeholder (the first owner is bound by his covenant in contract) could be changed by statute so as to make positive covenants run with freehold land which would enable a reduction in the special interest categories referred to in 3.2 of the consultation paper.

The Government could also look into ways for improving the commonhold system which has thus far not taken off, partly because there has not been the incentive for developers to build on this basis.

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President