

## **Response:**

# **Implementing reforms to the leasehold system in England**

**A Ministry of Housing, Communities and Local Government Consultation**

**26 November 2018**

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### Summary of key points:

- This consultation runs alongside separate reviews initiated by the Government, which address other issues such as onerous consent regimes and the difficulty and excessive cost of enfranchising and extending leases. These issues are all closely connected, and the various streams of work need to be seen in association with each other.
- We agree that serious abuses have emerged in the housing market in recent years and that the Government is right to review the situation urgently. Legislation is needed as soon as possible.
- We support the proposed ban on the sale of houses on leasehold terms, subject to exemptions for shared ownership housing, Community Land Trusts, and other cases where leases are essential. We are pleased that the consultation paper accepts the case for these exceptions.
- We agree that (subject to suitable exemptions) ground rents should be subject to a strict upper limit so that they no longer allow the extraction of a significant profit from purchasers. We agree that the proposed limit of £10 per annum will achieve this purpose.

## **1. Introduction**

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This is the formal response of the National Housing Federation to the consultation by the Ministry of Housing, Communities and Local Government (MHCLG) on reforms to the leasehold system in England. The National Housing Federation is the voice of housing associations in England and our members are united by a common purpose – to ensure everyone has access to a quality home that they can afford.

## **2. Background**

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The current consultation paper forms part of a programme of parallel reviews initiated by the Government to examine the role of leasehold tenure in the residential housing market in the light of abuses that have become increasingly evident in recent years.

The issue first emerged because of concerns about the practice of selling new homes subject to long leases with ground rents that escalate rapidly in the later stages of the lease.

Once the issue of escalating ground rents achieved political salience, however, it became clear that this was only one of a number of abuses, not all of them necessarily associated with the use of leasehold tenure. Notably, it became clear that many homes were being sold subject to onerous prohibitions framed with a view to generating an income by charging handsomely for granting waivers. This is a device that can be applied even to freehold houses by means of a suitably worded deed of sale.

The Government's interest in the subject therefore broadened to cover a greater range of issues, and separate reviews are currently ongoing looking at consent regimes and the enfranchisement and extension of leases. We refer to these in passing in this response.

The present MHCLG consultation, however, focuses on the implementation of two policies announced by Government in December 2017:

- a ban on the sale of houses on leasehold terms (subject to certain exceptions);
- a strict upper limit on ground rents (also subject to exceptions).

Both these measures will require legislation, as will many of the other proposals currently under consideration to deal with abuses in the housing market.

The interests of housing associations are engaged in two ways.

First, associations are freeholders of large amounts of property subject to long leases. This will include all their shared ownership properties (except where houses have been staircased to 100%) and all flatted property that has been sold, whether as part of a market sale scheme or where the Right to Buy or Right to Acquire has been exercised. Associations take seriously their responsibilities as freeholders and do not charge excessive ground rents. They will, however, be subject to any legislation designed to protect leaseholders, so it is important to ensure that such legislation is well-considered and proportionate, and avoids unintended consequences for responsible freeholders.

Second, associations are major developers. Although they do not engage in mechanisms, such as escalating ground rents on burdensome consent regimes that are designed to extract a continuing

income stream from purchasers, they may find themselves in competition for land with less scrupulous private developers that do behave in this way. It is very likely, however, that the additional income stream anticipated by such a developer will allow it to outbid a housing association, or a more traditional private developer, that does not use this approach. If nothing is done to check these practices, developers that do not engage in them risk being driven from the market.

### **3. Federation's views**

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The Federation agrees that serious abuses have emerged in recent years, most notably in relation to leaseholds but also involving other aspects of the housing market.

Paragraphs 2.2 and 2.3 of the consultation paper point out that the proportion of new build houses sold on long leases, rather than freehold, has more than doubled in the last twenty years and that many of these are 'standalone houses with no shared facilities or fabric [that] have been built and sold as leasehold simply to create a revenue stream for whoever owns the freehold'.

We agree completely.

The use of long leases in this way is one of a number of mechanisms that have emerged in recent years, often based on leases but sometimes applying to freehold properties as well, that allow profits to continue to be extracted from homeowners in addition to the taking of profit in the traditional manner at the point of sale. These mechanisms, if allowed to continue unchecked, will distort the operation of the housing market and could even damage the reputation of home ownership as a form of tenure.

We agree that legislative solutions are urgently required.

#### **3.1 Proposed ban on the sale of houses on long leases**

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We agree with the Government that for newly built houses (as opposed to flats), freehold sale should be the norm and exceptions to this ought to be rare. In particular, we think it is a serious abuse to retain the freehold in order to maintain a source of future profit. We therefore support, in principle, the Government's proposal to prohibit (with certain exceptions) the leasehold sale of new houses.

In saying this, we want to be clear that the sale of leasehold houses does not necessarily indicate that the developer is seeking to extract continuing profits from purchasers. In the first place, there are cases, such as shared ownership housing, where the ownership structure requires the creation of a long lease. In Community Land Trusts (CLTs), too, the continuing relationship between the CLT and the individual owners is best expressed through a long lease. In our initial submission to the Government on leasehold abuses in September 2017, we pressed for the complete exemption of shared ownership and CLTs, and we are pleased that Government has accepted this argument.

Even where these special circumstances do not apply, however, there are some parts of the country where the sale of houses on long leases is well established as customary practice, going back many decades. In these areas, many developers, including some housing associations, have a long record of selling houses on long leases that strike a fair balance between freeholder and leaseholder and do not contain any onerous terms such as large or steeply escalating ground rents or exploitative

consent requirements. We accept, however, that the ban on new leases on houses will apply to all developers, unless their housing falls within one of the statutory exemptions.

However, simply banning new leases on houses does not fully address the problem. In the first place, large numbers of new properties, most notably flats, will continue to be sold on long leases. Moreover, there is increasing evidence that some developers are selling homes on terms that are freehold in a formal sense, but that nevertheless maintain many of the profiteering mechanisms that are associated with the more exploitative types of lease. Therefore, even after the leasehold sale of new houses is banned, it will still be necessary to legislate to protect leaseholders and to prevent the attachment of onerous conditions to freehold sales. We are glad that the Government has recognised this.

To sum up, it is our view that the underlying problem is not only the leasehold sale of houses but the growing practice, in some parts of the property market, of devising mechanisms that exploit homeowners as a source of continuing profit. These mechanisms relate both the houses and flats, and not only to leasehold property but increasingly to freehold as well. The focus should therefore be not so much on the exact form of tenure but on shutting off these sources of profit, thereby also killing off the market that has developed in trading them.

### **3.2 Ground rents**

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As the consultation acknowledges, the issue of leasehold abuses is by no means confined to rapidly escalating ground rents, but it is this aspect that has attracted most attention, so we address it first.

We are quite clear that ground rent should be set at a low level and that excessive ground rents are an abuse. This applies particularly to the practice of 'back-loading' ground rent so that it may be relatively modest in the early stages of the lease but escalates rapidly over time. The effect is likely to be to lure unwary purchasers, unversed in property law and inadequately advised, into acquiring a lease that will involve rapidly increasing costs over time and is likely to become unsalable. The endemic shortage of housing in many parts of the country is also likely to mean that purchasers are desperate to acquire any apparently suitable property, regardless of possible problems in the small print of the sale.

Although the leaseholder will normally have a statutory right to enfranchise, the freeholder's expectations from the escalating ground rent mean that the cost of enfranchisement will be far higher than usual and is likely to be beyond the means of many leaseholders.

The fact that certain developers have been successful in selling leases on such onerous terms suggests that buyers' solicitors and mortgagees have failed to apply proper scrutiny to the transaction. We hope that the attention that this issue has now received will lead them to be much more attentive to detail; if so, it will become much more difficult to find a buyer for a lease of this type. This would be a most welcome development, although of course it will do nothing to assist existing purchasers.

We therefore agree that the Government should legislate to limit residential ground rents on future leases to a modest amount. This should apply across the board, to leases of flats as well as houses, and it should apply not only to leases of new properties but also to new or extended leases in respect of existing properties (whether the extension is effected through the statutory mechanism or by voluntary negotiation between the freeholder and leaseholder).

Regarding the amount to which the ground rent should be limited, the Government originally proposed a peppercorn (i.e., an entirely notional amount) but has now put forward a figure of £10 per annum. We have attended meetings in which some representatives of the property industry have protested that a ground rent at this level is too low to be of use to them. With all due respect to them, we argue this is precisely the point. The aim should be to set the maximum ground rent at a level that is too low to offer prospects of a meaningful (and tradable) profit. We are therefore happy to support the Government's proposed £10 limit.

We agree, however, with the representations of the commercial property sector about the importance of stewardship of the building. A residential building, if it is well constructed and well maintained, should be capable of providing safe, attractive housing of high quality for many decades or even centuries. The freeholder's responsibility for the building is likely to cover a far longer timescale than that of most leaseholders and we agree that the freeholder is best placed to take a long-term view so that the useful life of the building is maximised.

However, we do not agree with the argument, advanced by some commercial owners, that it is the purpose of ground rent to pay for the stewardship role. The weakness of this argument is clear from the fact that the obligation to pay ground rent is inherent in the lease and applies whether or not the freeholder is exercising satisfactory stewardship. In other words, even if the freeholder were to neglect the building entirely, its entitlement to collect ground rent would be undiminished. Whilst agreeing about the importance of stewardship, therefore, we argue that the service charge (or management charge) is the appropriate mechanism for recovering any costs reasonably involved in the course of stewardship. This provides appropriate accountability because the freeholder is obliged to explain and justify its spending, and the leaseholder has the opportunity to take any grievance to the First-Tier Tribunal.

### **3.3 Prohibitions and consents**

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It is clear that ground rents are not the only area of abuse. Some leases contain detailed and stringent prohibitions that the freeholder will, however, consider waiving on receipt of a fee. This has become a lucrative source of revenue for some exploitative freeholders. Although conditions are a reasonable and normal element within leases, it is clear that in some cases the conditions have been written not in order to protect any reasonable interest of the freeholder or other occupiers but simply in order to generate waiver requests for which exorbitant fees can be charged.

This abuse is not confined to leaseholds. Similar regimes can be created through the deed of sale even where the property is sold on freehold terms.

The Government has established a separate review chaired by Lord Best to examine this issue and we do not propose to discuss it in detail in this response, but it is important that any legislation that aims to remedy abuses of the leasehold system should also deal with exploitative consents regimes both in leases and in the freehold sector.

### **3.4 Existing residential owners subject to onerous terms**

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The thrust of the consultation paper is about avoiding the imposition of onerous terms in future sales, and we have reflected this in our response. However, we acknowledge that there are a substantial number of existing homeowners subject to these terms. Moreover, they are likely to be trapped since

lease enfranchisement will be very costly, while the attention the subject has now received means that the property will be virtually unsalable.

We note that the Government has asked the Law Commission to undertake urgently a parallel piece of work examining the enfranchisement and extension of leases. The Commission has issued a substantial paper on the subject and has invited views by 7 January 2019. We shall respond to this shortly, arguing that legislation should provide for existing leaseholders to extend or enfranchise their leases at a cost that is substantially lower than under existing legislation and that should be calculated without regard to any actual or prospective benefit to the freeholder of excessive ground rent, an exploitative consents regime, or any other unfair practice. The legislation should override any contrary provisions in the lease.

### **3.5 Commonhold**

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There have been suggestions that the use of commonhold offers a potential remedy for the abuses identified in the consultation paper.

We note, however, that the legislation enacted in 2002 remains on the statute book but its commonhold provisions are a virtual dead letter, used on only a handful of instances. This unsatisfactory experience underlines the importance of taking time to get the legislation right. We argue that there is a pressing need to deal quickly with the serious abuses identified in the consultation, and we do not think the matter should await a full-blown review of commonhold.

However, we agree that that it is timely to embark on a re-examination of the potential of commonhold as an alternative to traditional leasehold, or possibly as a complete replacement of it. Any such review should consider how to support individual members of a commonhold association so that they are in a position to manage and maintain the building as well as provide long-term stewardship of it.

## **4. Answers to consultation questions**

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### **Question 1: Do you have views on any further means to implement the ban on unjustified new residential long leases being granted on non-exempt houses?**

We agree with the proposed mechanism of using land registration to ensure that the ban on new leases of houses is enforced. Conveyancing solicitors, particularly those working for the purchaser, will also have a role in ensuring that the ban is not evaded.

### **Question 2: Do you have any views on how to provide appropriate redress for homeowners should (a) a long lease be incorrectly granted upon a house or (b) a long lease be granted at a ground rent in excess of the cap, after the legislation has taken effect?**

We think it unlikely that evasion will be a significant issue. If it occurs, we suggest that the purchaser should be able to go to court to have the terms of sale converted to freehold (at no additional cost to the purchaser). Likewise, any rental term in excess of the cap should be interpreted as being at the level of the cap (unless an exemption applies), and any money paid in excess of the limit should be recoverable with interest.

**Question 3: To ensure there is a workable definition of a ‘house’, we would welcome your views on the type of arrangements and structures which should or should not be considered to be a ‘house’ for the purpose of the new ban on leasehold houses.**

We are aware of the current dialogue between lawyers about how to define a house but we are not in a position to contribute except to say:

- it is important to keep in mind that the uncertainty about what constitutes a ‘house’ affects only a tiny minority of the properties potentially affected by the leasehold ban, and that in the great majority of cases it is not in dispute whether the property does or does not amount to a ‘house’; and
- it is important that any precise legal definition should align as closely as possible to the general public’s understanding of what is a very familiar English word.

**Question 4: With the exception of community-led housing, do you agree that any exemptions provided which allow the continued granting of new long leases on houses should have their ground rents restricted as proposed?**

We agree, subject to the point that legislation needs to cater for the fact that the term ‘rent’, as a legal term, does not distinguish between ground rent, as commonly understood, and rent charged in respect of the landlord’s retained equity in shared ownership properties (see also Q14). We also accept that there may be a case for allowing a higher ground rent in retirement housing schemes (see Q11 and Q16).

**Question 5: Are there any other conditions that should be applied to exemptions from the leasehold house ban to make them acceptable to consumers?**

Not so far as we are aware. We argue, though, that where there are communal services in a scheme involving houses (as opposed to flats), a satisfactory rentcharge regime will be needed (see Q23).

**Question 6: Do you agree that there should be an exemption for shared ownership houses?**

Yes. This is essential because a lease is the only legal mechanism by which the relationship between freeholder and shared owner can be given proper effect. We agree, though, that if a shared ownership house is staircased to 100%, the freehold should normally be transferred at that point (as is already standard practice).

**Question 7: Do you agree that there should be an exemption for community-led housing developments such as Community Land Trusts, cohousing and cooperatives?**

Yes. Developments of this kind depend for their success on an enduring relationship between owners and the developer, imposing significant obligations on both parties. These obligations can be given legal effect only through a lease.

**Question 8: We would welcome views on the features or characteristics that should be included within a definition of community-led housing for the purposes of an exemption.**

We agree with the proposed definition: housing where the freehold is owned by a not-for-profit body established for the benefit of the local community specifically.

**Question 9: Do you agree that there should be an exemption for land held inalienably by the National Trust and excepted sites on Crown Trust land?**

As the trade body for housing associations, we do not have a position on this issue.

**Question 10: Do you agree that the law should be amended to allow the inclusion of newly created freeholds within existing estate management schemes?**

Yes, but please see also the answer to the following question.

**Question 11: Are you aware of any other exceptional circumstances why houses cannot be provided on a freehold basis that should be considered for an exemption, in order to protect the public interest or support public policy goals?**

Retirement housing schemes, whether run by the for-profit sector or by non-profit bodies such as housing associations, discharge a socially useful role and should be supported. Most properties in these schemes are flats and can only be sold on leases, but some schemes include houses and there is an active debate among providers about whether it will still be possible to provide these should leasehold sale be banned. We advise the Government to consult closely with the sector and retain an open mind about whether an exemption may be justified in retirement housing schemes (and see also Q16).

We do not have a view on the issue of agricultural leases.

**Question 12: Do you agree that there should be no further transitional arrangements after the commencement of the legislation to permit the sale of leasehold houses?**

Yes. The Government announced in 2017 that it intended to legislate, and it is unlikely that any legislation will take effect before 2021. This is ample time for developers to adjust their practices.

**Question 13: Are there justifiable reasons why ground rents on newly created leases should not be capped as a general rule at a maximum value of £10 per annum, but instead at a different financial value?**

The important point is to set the cap at a level that is too low to allow the extraction of a significant continuing profit. The suggestion of £10 per annum clearly meets this requirement. We suggest that, if the Government is to adjust the existing law governing the collection of ground rents as proposed in paragraph 3.16, it would be helpful to incorporate specific provision allowing ground rent to be demanded in conjunction with (but provided it is clearly distinguished from) the service charge.

**Question 14: Are you aware of a separate ground rent being charged in addition to a rent on the retained equity in shared ownership leases?**

We understand that this is the practice in some cases, and we point out that the legal concept of 'rent' is broad enough to encompass both ground rent, as the term is commonly understood, and the rent in respect of the landlord's retained equity in shared ownership housing. How exactly the rental obligation is structured will vary from one shared ownership lease to another, but we agree that any element of the rent that is contingent on the existence of the lease, rather than on the landlord's retained equity, should be subject to the same limit as would apply to any other residential lease.

**Question 15: Do you represent a community-led provider which does not rely on ground rent income?**

Although the Government proposes to exempt community-led providers from the ban on leasehold houses (and we welcome this), it does not follow that every such organisation wants or needs to use leases for the purposes of levying ground rent as a source of income. In many cases, it will be because the lease is the best way of embodying the respective obligations of the community-led body and the individual owners. Whether ground rent is required as a source of income will vary from one such organisation to the next, so it is not possible to generalise about whether this is an important issue for community-led schemes. However, where a community-led organisation does generate a significant income through ground rents, it should be transparent about why the money is needed and how it will be used.

**Question 16: Do you agree that there is a case for making specialist arrangements permitting the charging of ground rents above £10 per annum for properties in new build retirement developments?**

We agree, provided that the scheme is clear and transparent, well before the point of purchase and throughout the period of ownership, about the fact that such a ground rent will be charged, why it is needed, how it is set, and how it is spent. If the scheme meets these requirements for a specified economic ground rent, we question the necessity of allowing a choice as suggested in paragraph 3.31 because the effect would be to require the operation of parallel financial arrangements for different residents and this would be operationally difficult as well as potentially giving rise to concerns about fairness. See also Q11.

**Question 17: What positive or negative impacts does paying ground rents have on older people buying a home in the retirement sector?**

Ground rents in excess of the usual cap may reduce the cost of purchase but will also reduce the resale value of the lease. These issues should be put clearly before potential buyers so they can make an informed choice. However, as noted in response to the previous questions, we have reservations about operating both approaches in parallel in the same scheme. We urge the Government to maintain its dialogue with the retirement housing sector.

**Question 18: Do you agree with our approach to the treatment of mixed use leases?**

We agree. Leases for commercial purposes, whether wholly or in part, are clearly outside the scope of the current proposal.

**Question 19: Are there any other circumstances in which mixed use (a) should be within scope of the policy or (b) excluded from the scope of the policy?**

Not that we are aware of.

**Question 20: Do you agree with the circumstances set out in paragraphs 3.34 to 3.37 in which a capped ground rent will apply in replacement leases?**

Yes. It is particularly important that the cap should apply to leases regranted as a result of private negotiation, because otherwise unscrupulous freeholders may seek to deprive leaseholders of their statutory protections by coaxing them into privately negotiated arrangements.

**Question 21: Do you agree that there should be no further transitional period after commencement of the legislation permitting ground rents above £10 per annum?**

Yes. The Government announced in 2017 that it intended to legislate, and it is unlikely that any legislation will take effect before 2021. This is ample time for developers and freeholders to adjust their practices.

**Question 22: Should we provide freeholders with a right to change the management of services covered by an estate rent charge or contained within a deed of covenant arrangement?**

In general, freeholders paying for services through a rent charge or other mechanism should enjoy similar rights to tenants and leaseholders paying a service charge. In principle, this should include the right to require a change of service provider, but we suggest that in practice this will be less important than a right to challenge charges at the First-Tier Tribunal (FTT). And as we mention in our narrative response, the right to challenge exploitative consent regimes at the FTT will also be an important protection.

**Question 23: What will be the impact of these proposals (paragraphs 4.8 to 4.10) on companies or bodies that provide the long-term management of communal areas and facilities?**

It is important to have a legally robust mechanism that allows the costs of providing and managing communal facilities to be recouped from those entitled to benefit from them. Long leases provide such a mechanism, but it is equally important to be able to recoup reasonable costs from freeholders. This has assumed increasing importance in recent years because many local authorities have become increasingly reluctant to adopt common parts, such as grassed areas, in new housing developments.

In these circumstances, so that the costs can be borne fairly by all residents regardless of their exact tenure, a rentcharge (or some other effective system of charging) needs to be available for use with respect to freehold properties. We urge the Government to examine the practical operation of rentcharges, and similar regimes, and if necessary bring forward measures to ensure that they are fit for purpose, transparent and fair.

Freeholders subject to a charging regime should enjoy the same rights as service charge payers to receive information from the charging body, to be consulted by it, and to challenge the charges at the First-Tier Tribunal.

**Question 24: What would constitute a reasonable deadline for managing agents and freeholders to provide leasehold information?**

With regard to this and the following two questions, we acknowledge the issue the Government has raised but we also agree with the feedback from practitioners that the nature of leasehold information varies from case to case and in some instances it can be very complex. In these circumstances it is difficult to set standard fees and timescales. Consideration should be given to developing a code of practice that would set out normal expectations, whilst allowing an element of flexibility where the information is unusually complex or difficult to obtain. We agree that the onus should be on the freeholder or managing agent to show good cause in the event of any unusual delay or if the fee is higher than normal, and that there should be a means of recourse in the event of undue cost or delay.

**Question 25: What would constitute a reasonable maximum fee for managing agents and freeholders to provide leasehold information?**

See Q24.

**Question 26: What would constitute a reasonable fee for managing agents and freeholders to update leasehold information within six months of it first being provided?**

See Q24.