



Department for
Communities and
Local Government

Tackling unfair practices in the leasehold market

A consultation paper



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Scope of the consultation

Topic of this consultation:	<p>This consultation particularly seeks views on:</p> <ul style="list-style-type: none"> i) prohibiting the sale of new build leasehold houses where the developer is not obliged to sell a house on a leasehold basis; ii) restricting ground rents on new leases to a ‘peppercorn’; iii) how to tackle existing onerous ground rents; iv) possible changes to the Help to Buy scheme in relation to leasehold houses; v) providing freeholders on private estates with equivalent rights to leaseholders to challenge unreasonable service charges for the upkeep of communal areas and facilities via the First-tier Tribunal (Property Chamber).
Geographical scope:	These proposals relate to England only.
Impact Assessment:	<p>DCLG estimates there were 4.0 million leasehold properties in England in 2014-15 and of these 1.2 million were leasehold houses.</p> <p>In 2016 around 10,000 new build leasehold houses were sold, out of around 57,000 sales of leasehold houses in England. We do not know how many leaseholders are affected by onerous ground rent terms and we are looking to industry and others to provide more detail about the potential impact of different proposals. The information provided will inform Government policy and any assessments required under the Government’s Better Regulation Framework for this parliament.</p>

Basic Information

Duration:	This consultation will last for 8 weeks from 25 July 2017 until 19 September 2017.
1	<p>We encourage you to respond by completing an online survey at: https://www.surveymonkey.co.uk/r/leaseholdhouse</p> <p>Alternatively you can email your response to the questions in this consultation to: LeaseholdHousesConsultation@communities.gsi.gov.uk</p>

If you are responding by email or in writing please make it clear which questions you are responding to.

When you reply it would be very useful if you confirm whether you are replying as an individual or submitting an official response on behalf of an organisation and include:

- your name,
- your position (if applicable),
- the name of organisation (if applicable),
- an address (including post-code),
- an email address (if you have one), and
- a contact telephone number.

1. Introduction

- 1.1 Leasehold is a significant and increasing tenure for new homeowners. On 6 April 2017 the Department for Communities and Local Government published statistics estimating there were 4.0 million residential leasehold dwellings in England in the private sector in 2014/15.¹
- 1.2 The percentage of residential sales that were leasehold grew across England between 2011 and 2015². Land Registry figures show that leasehold made up 43 per cent of all new-build registrations in England and Wales in 2015, compared to 22 per cent in 1996³. Many parts of England have seen an increase in the development of flats which are sold on a leasehold basis.
- 1.3 The last major legislative reform to leasehold was the Commonhold and Leasehold Reform Act in 2002, although the Government took action in 2014 to cap repair charges imposed on leaseholders by government-funded public sector landlords⁴. Leasehold legislation is complex and spread across several Acts of Parliament. Many prospective leaseholders are not fully aware that this form of tenure involves a landlord – tenant relationship, or of the significant financial and other interests they sign up to, or the range of rights and responsibilities for each party as set out in the formal contract between them: the 'lease'. Redress is mainly through courts and tribunals, which can be costly and prolong uncertainty.
- 1.4 Concerns regarding the transparency and fairness of selling new houses on a leasehold basis and about the level of ground rents were raised in a House of Commons debate in December 2016⁵. The All Party Parliamentary Group on Leasehold and Commonhold is also advocating for reform in these areas.
- 1.5 Sajid Javid, the Secretary of State for Communities and Local Government, has stated *"as a government committed to building a fairer society, I don't see how we can look the other way while these practically feudal practices persist"*. In addition *Forward Together*, the Conservative and Unionist Party Manifesto 2017⁶ commits to *'crack down on unfair practices in leasehold'*.

¹ <https://www.gov.uk/government/statistics/estimating-the-number-of-leasehold-dwellings-in-england-2014-to-2015>

² <http://www.conveyancingassociation.org.uk/wp-content/uploads/2016/11/Modernising-the-Home-Moving-Process-White-Paper1.pdf>

³ <https://www.ft.com/content/8148fc96-501f-11e6-8172-e39ecd3b86fc> Financial Times, 'Leasehold flats: what estate agents don't tell you' (July 29 2016)

⁴ <https://www.gov.uk/government/news/flos-law-new-cap-for-council-house-repairs-comes-into-force>

⁵ <https://hansard.parliament.uk/commons/2016-12-20/debates/4F15110B-F6D5-4FA1-9154-536BD848130E/LeaseholdAndCommonholdReform>

⁶ <https://www.conservatives.com/manifesto>

- 1.6 The Government's Housing White Paper '*Fixing our broken housing market*⁷ published in February 2017 highlighted the Government's aim to improve consumer choice and fairness in the leasehold sector and committed to consult on a range of measures to tackle unfair and unreasonable abuses of leasehold. It cited new leasehold houses and onerous ground rents as areas where the most urgent reform may be needed, and signalled our intention to look at wider reforms in the medium-term. This consultation seeks views on such reform. It also explores measures to exclude leaseholders from possession orders due to ground rent arrears, as allowed by the Housing Act 1988, and measures to provide freeholders with the right to challenge the reasonableness of service charges on private estates via the First-tier Tribunal (Property Chamber).
- 1.7 This consultation applies to England only and asks specific questions on:
- i) Prohibiting the sale of new leasehold houses (with possible exceptions where developers are *obliged* to sell a house on a leasehold basis.)
 - ii) Possible changes to the Help to Buy scheme in relation to leasehold houses.
 - iii) Limiting the starting value and increase of ground rents on all new residential leases over 21 years.
 - iv) Updating Ground 8 of the Housing Act 1988 so long leases over 21 years with an annual ground rent over £1,000 in London and £250 outside of London cannot be an Assured Tenancy.
 - v) Providing freeholders on private estates with equivalent rights to leaseholders to challenge the reasonableness of service charges via the First-tier Tribunal (Property Chamber).
 - vi) Areas for future leasehold reform.
- 1.8 All responses to the paper should be submitted no later than midnight on 19 September 2017. We encourage respondents to use the online survey available at:

<https://www.surveymonkey.co.uk/r/leaseholdhouses>

although written responses can also be emailed to:

LeaseholdHousesConsultation@communities.gsi.gov.uk

or sent to;

Leasehold and Rentcharges Team
Department for Communities and Local Government
Third Floor – Fry Building

⁷ <https://www.gov.uk/government/publications/fixing-our-broken-housing-market>

2, Marsham Street
London
SW1P 4DF

1.9 A full list of questions asked in this consultation can be found at Annex A.

To help us analyse the consultation responses, we would ask you to answer the following questions:

Questions:

Q1: Are you responding as (please tick one):

- A private individual?
- On behalf of an organisation?

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

- An owner or tenant of a leasehold flat?
- An owner or tenant of a leasehold house?
- An owner of a freehold house?
- A private landlord?
- An individual with a portfolio of ground rents?
- Other? (Please specify)

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

- A residents' management company or right to manage company?
- A developer?
- An organisation representing leaseholders?
- An organisation representing freeholders?
- A lender?
- A solicitor / conveyancer?
- An estate agent?
- An organisation representing lenders?
- A supplier of management and/or other services to leaseholders?
- Other private landlord?

- A social landlord (either Registered Provider or local authority)?
- A developer of other housing tenures besides leasehold houses?
- A company that buys and sells ground rents?
- An investment company or pension fund that has a portfolio of ground rents?
- A local authority?
- Other (please specify)?

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):

2. Glossary of terms used in this document

Landlord

- 2.1 The landlord is the person or organisation who owns the freehold (or superior leasehold interest) and may also be called the lessor or freeholder. This means that they retain ownership of the land on which the property is built. The landlord has a defined legal relationship with the leaseholder governed by the lease and relevant legislation. The landlord can be an individual person or a company, including a local authority or a housing association and can also be a Residents' Management Company named in a lease or a Right to Manage Company that has acquired the statutory right to take over the landlord's management functions.

Lease

- 2.2 A lease is a legally binding document, or contract, giving the leaseholder the exclusive possession of a property for a fixed period of time. The terms of the lease determine the rights and responsibilities of the landlord and leaseholder in respect of the property and cannot usually be changed without the agreement of all parties or an application to a tribunal or court for a variation.

Leasehold

- 2.3 A long leasehold is a form of property ownership normally used for flats that is simply a long tenancy, providing the right to occupation and use for a long period – the 'term' of the lease. This can be a period of over 21 years and the lease can be bought and sold during this term. The term is fixed at the beginning and decreases year by year, until the property returns to the landlord (although an assured tenancy would then become a possibility). Houses can also be leasehold. A person who buys a leasehold property on a lease is called a leaseholder.

Freehold

- 2.4 The freehold interest in land (sometimes referred to in legal terms as fee simple absolute in possession) is a title in property that can be held in England and Wales. In practice a residential freehold interest applies to the outright ownership of land or property for an unlimited period and applies to the majority of houses. However, there may be legal and planning related restrictions on what a freeholder can do to modify their property and land. There is a distinction between a freehold interest in a real estate asset and freehold ownership of an asset. The former implies that there is a lease over the property and there being two interests in that land. The latter implies a single interest.

Enfranchisement

- 2.5 The purchase of a freehold interest in a house, where the leaseholder of the house may buy the freehold. Enfranchisement can also take place in a building containing flats, where leaseholders act together to exercise a right to collectively buy the freehold.

Ground rent

- 2.6 Because a leasehold is a tenancy, it is subject to the payment of a rent to the landlord. Ground rent can vary from a nominal value to a significant amount that increases over the term of the lease. Ground rent is a specific requirement of the lease and must be paid on the due date. The term “peppercorn rent”, is an historic term which means a ground rent has no financial value.

Right to Manage

- 2.7 The Right to Manage is a statutory power⁸ which enables qualifying leaseholders of a building to take on its management without having to prove their existing manager is at fault. Right to Manage is only available to leasehold flats and maisonettes; it is not available to individual leasehold houses or estates.

⁸ Commonhold and Leasehold Reform Act 2002, Part 2 Leasehold Reform
<http://www.legislation.gov.uk/ukpga/2002/15/part/2>

3. Limiting the sale of new build leasehold houses

Leasehold houses

- 3.1 Leasehold is primarily used to manage properties that share a single space and have shared facilities – like collective responsibility for the upkeep of roofs, lifts and entrance halls in blocks of flats and where houses have been converted into flats. Leasehold is the way most flats are owned, although some houses are sold on a leasehold basis too, including those in a shared ownership scheme. It is not the only way that houses with communal space can be owned though, with some freeholders also having responsibility for shared grounds, for example car parks, through restrictive covenants.
- 3.2 Some houses have been sold as leasehold due to unusual circumstances – for example because they are on National Trust land or in a cathedral precinct. The Leasehold Reform Act 1967 highlights a number of specific circumstances where a leaseholder of a house is prohibited from extending their lease or enfranchising (purchasing the freehold), including where a leasehold house is:
- within a cathedral precinct;
 - on National Trust or Crown land;
 - on land owned by local authorities and university bodies with the right for future development;
 - in shared ownership with a ‘restricted staircasing’ lease;
 - of special architectural or historic interest or adjoining properties where it is important in safeguarding them and their surroundings.
- 3.3 New build leasehold houses may be sold in Garden Villages⁹. Once the development of the Garden Village is complete, a development company might then transfer its assets. This could be by way of an endowment to a community land trust. This trust would then be responsible for long term stewardship, through the formation of a Board of Management and governed by local people, who would make decisions on behalf of the community.
- 3.4 Leasehold houses may also be sold in retirement villages, where a developer and provider of extra care and support services include ‘event fee’ provisions in a lease to allow residents to defer service charges or other costs to be recouped upon resale. These leasehold houses may be more expensive to build due to adaptations, and event fees can help to cover the cost of the more inefficient use of space which adaptations may require.

⁹ <https://www.gov.uk/government/news/first-ever-garden-villages-named-with-government-support>

- 3.5 Where a developer owns the freehold they can currently choose to market and sell a new house either on a leasehold or freehold basis, or both. One would expect the sale price of the house to be higher if sold freehold, reflecting the greater monetary value of the freehold interest, but it is not clear the 'leasehold discount' is always passed on to the consumer.
- 3.6 Leasehold houses are more prevalent in the North of England. Developers argue that the sale of new build leasehold houses in some areas of England is an accepted custom and practice, and that selling a freehold house could create a potential competitive disadvantage. In some parts of northern England this has resulted in leasehold becoming the default tenure for consumers wanting to buy a new build house. It is particularly common practice in parts of Cheshire, Greater Manchester, Lancashire and Merseyside, but is not limited to these parts of the country.
- 3.7 The Department for Communities and Local Government estimate that there were 1.2 million leasehold houses in the owner occupied and private rented sectors in 2014/15¹⁰. Increasingly, new build houses are being sold as leasehold in parts of the country where they had not been before. Some of these have no shared services or facilities, and there appears to be no obvious reason why the freehold is not sold at the point of sale.
- 3.8 The Government is concerned that new build houses are being sold on a leasehold basis to create an income stream from the ground rent, or to generate additional income from the sale of the freehold interest after contracts have been exchanged. The Government thinks that this represents poor value for consumers.
- 3.9 On the 1 March 2017 the Prime Minister speaking in the House of Commons highlighted, "*.....we will act to promote fairness for the growing number of leaseholders...we will consult on a range of measures to tackle unfair and unreasonable abuses of leasehold, as the Housing Minister has said. Other than in certain exceptional circumstances, I do not see why new homes should not be built and sold with the freehold interest at the point of sale*".¹¹
- 3.10 Annex B provides more detail on how a house is defined.

What is the impact on consumers?

- 3.11 Where leasehold and freehold purchase options are both available for a new build house, the comparative costs and benefits of each may not be explained to consumers and there is a risk that consumers may lose out financially.

¹⁰ <https://www.gov.uk/government/statistics/estimating-the-number-of-leasehold-dwellings-in-england-2014-to-2015>

¹¹ <https://hansard.parliament.uk/commons/2017-03-01/debates/62A8D14B-06F5-461B-B9F9-D20941A86413/Engagements> (column 295)

- 3.12 A leasehold house may be presented as a cheaper option than buying the freehold but it is not always clear that the initial 'discount' on the sale price of a leasehold house reflects the additional medium to long term costs leaseholders may face. These include: paying an increasing and continuing ground rent; paying potential fees for permissions to make alterations to a property or covenants in a lease; and the financial impact of extending the lease or buying the freehold from the developer after moving in. These costs can total thousands of pounds more than envisaged at the point of sale.
- 3.13 In addition, where developers sell on the freehold interest to a third party after a leaseholder has moved into a new build house, consumers can find that they are faced with significant legal and surveyor costs where they want to purchase the freehold. Such transfers can take place without the leaseholder being informed. The Government does not think this is in consumers' best interests.
- 3.14 Developers and landowners argue that restricting their ability to sell on freehold interests to third party investors will result in increased house prices, in order to compensate developers for selling the freehold interest to the purchaser, and will reduce choice. The Government is not convinced of these arguments.

Questions:

Q5: What steps should the Government take to limit the sale of new build leasehold houses?

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

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

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

Reducing Help to Buy Equity Loan support for leasehold houses

- 3.15 In a speech on 28 March 2017, Sajid Javid, the Secretary of State for Communities and Local Government, confirmed that he will look to ensure that Help to Buy Equity Loans are only used to support new build houses on acceptable terms.¹²
- 3.16 We propose to remove as far as possible Help to Buy Equity Loan support on new build houses where these are sold as leasehold. Only where there are specific circumstances to justify the use of leasehold will Help to Buy Equity Loan support the sale.

¹² <https://www.gov.uk/government/speeches/helping-builders-to-get-building>

3.17 In the cases where leasehold houses can be justified, Help to Buy Equity Loan support would only be available if the ground rent terms are reasonable. We would aim to introduce this non-legislative policy change as soon as practicable.

Questions:

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?

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

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

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

4. Limiting the reservation and increase of ground rents on all new residential leases over 21 years

What is ground rent?

- 4.1 When purchasing a leasehold property with a long lease, (originally for a period over 21 years), a leaseholder enters into a long term tenancy and ground rent is the consideration underpinning the establishment of a contract between a leaseholder and their landlord. Leaseholders with a long lease in England will normally pay ground rent to their freeholder or landlord for renting the land that the leasehold property is on. The amount of ground rent payable is set out in the lease and is normally paid annually. A lease will also include ground rent review clauses setting out how often and the rate or amount by which ground rent can increase.
- 4.2 Leaseholders receive no return or value for the ground rent, in contrast to payment of service charges or managing agent fees for looking after a building.

How are ground rents priced and why are they increasingly being traded?

- 4.3 Historically many ground rents were set at a 'peppercorn' instead of a financial value to save the landlord having to collect the rent. In theory the landlord could still demand the 'peppercorn', but in effect it meant there was no ground rent to pay. Where ground rents had a financial value these were normally at a nominal level reflecting a very small proportion of the initial sale price of the new lease, such as a thousandth of the initial sale price of the property.
- 4.4 A range of ground rent review clauses existed for leases sold on by developers and housebuilders in the 20th century. Even where these doubled every rent review period, the low nominal amounts and fairly long review periods meant that they were normally only held and sold on by a small number of investors. In some cases ground rents continued not to be collected by landlords.
- 4.5 In recent years the cost of ground rents has risen significantly, with some ground rents initially priced at 0.5 per cent or more of the property price. Direct Line for Business research in 2016 suggested that the average ground rent was £371 for new builds and £327 for older properties¹³.

¹³ <https://www.directlineforbusiness.co.uk/landlord-insurance/knowledge-centre/news/property-pain-service-charges-increasing-rapidly>

- 4.6 Developers are increasingly selling leasehold properties with shorter ground rent review periods, often every ten years. While many developers now increase ground rents at the end of each review period in line with the retail price index (RPI), there have been reports in the media of leaseholders facing onerous and unsustainable ground rents due to clauses in leases that permit ground rents to double every decade.
- 4.7 This has included cases of freeholders charging initial ground rents of £295 per year on properties purchased for just under £200,000, which increase to £9,440 per year after 50 years. In these cases the estimated cost of purchasing the freehold using a statutory valuation method would be over £35,000. In such cases leaseholders can also face difficulties selling or remortgaging.
- 4.8 Leaseholders with ‘doubling’ ground rent terms often report that they were not aware of the terms or the impact on the costs of enfranchisement. Where the time remaining on the lease falls below 80 years, these costs can be even more prohibitive.
- 4.9 Parts of the industry are taking action to support leaseholders with onerous extant ground rents. In April 2017 Taylor Wimpey announced it would set aside £130 million for a Ground Rent Review Assistance Scheme¹⁴ for its customers facing doubling ground rent terms. We welcome this, and are keen for others to follow suit.
- 4.10 Together with the other costs that leaseholders can be charged, including administration fees and costs of lease extensions and enfranchisement, the revenue stream that can be generated from leasehold properties is significant. The relatively low risk profile of ground rents and low interest rates has meant they have become more attractive to major investment funds. Developers have highlighted that the returns from selling on ground rents can be up to 35 times the annual ground rent value. In the current market this can be considerably more than the amount normally charged to the purchaser of a new build house for the freehold interest at the point of sale.
- 4.11 A CBRE Quarter 4 2015 Market View Long Income Valuation Report states that *‘The market for Ground Rent investments continues to move at a rapid pace. In spite of the recent resurgence in housebuilding there remains a fundamental demand and supply imbalance. This, coupled with the historical low yield fixed income environment, has pushed pricing upwards.’*¹⁵

Drivers for change

- 4.12 Paragraph 4.37 of the Housing White Paper *Fixing our broken housing market* states; *‘In particular, ground rents with short review periods and the potential to increase significantly throughout the lease period may not be offering a fair deal. We are absolutely determined to address this.’*

¹⁴ www.taylorwimpey.co.uk/leaseholdFAQ/

¹⁵ http://www://.groundrentsincomefund.com/wp-content/uploads/2012/10/Long-income_MarketView_Q4-2015-Final.pdf

- 4.13 Many new leaseholders face ground rent levels that are significantly higher in relative terms than those paid historically, and ground rent increases that are delivering favourable returns for landlords and third party investors. This is not in consumers' best interests and there are examples where the 'monetisation' of ground rents has led to abuse of the leasehold system.
- 4.14 For example, the Right of First Refusal means that, in most cases, a landlord wanting to sell their freehold interest must offer it to flat lessees before offering it at the same price to a third party. However, developers can get around this by drawing up a forward purchase agreement with an investor to acquire a scheme before all the long leases for flats in a block have been sold. This can result in the developer not being obliged to offer the freehold interest to the lessees ahead of a subsequent sale of the freehold.¹⁶

Limiting ground rent in a new lease

- 4.15 Currently residential leasehold law in England does not limit the level of ground rent payable in a lease. Leases are individual contracts between the freeholder and leaseholder setting out the responsibilities of both parties, including the payment of ground rent. Unlike service charges, the law does not state that ground rents should be 'reasonable'. How much ground rent is payable, whether this can increase, by how much and when, will depend upon the terms of the relevant lease. A landlord is unable to recover any more ground rent than specified in the lease, which itself cannot be varied except by mutual consent or by reference to a court or tribunal.
- 4.16 We would like views on limiting ground rents in new leases. Any change limiting ground rent would only apply to new leases, following any commencement of new legislation. New leases include those granted on a property for the first time or where a new lease is granted after a lease has expired (and the tenant formally surrenders the tenancy or the landlord serves a notice to bring the tenancy to an end). Any changes implemented would not alter the process by which a qualifying leaseholder exercised their right to extend their existing lease under the Leasehold Reform, Housing and Urban Development Act 1993. Under this scenario a leaseholder in a flat would be able to access a peppercorn rent, but would have to compensate the freeholder for the loss of ground rent, as under current arrangements.
- 4.17 We are minded to introduce measures limiting ground rents in new leases to start and remain at a 'peppercorn' (zero financial) level. Exceptions could apply to housing association and local authority tenants exercising the Right to Buy where most ground rents are set to £10 per year. We need to consider the impact of this and what a more 'reasonable' ground rent regime would look like if a case was made for this.

¹⁶ http://www.cbre.eu/portal/pls/portal/res_rep.show_report?report_id=2854

- 4.18 We also want to explore the range of means by which fairer ground rents might be achieved. For example, in May 2017 Nationwide changed its mortgage terms resulting in the building society not lending on properties with ground rents that double every 15 years or less, instead stating ground rent increases should be linked to a verified index, such as the RPI. In addition, for new build properties purchased from developers, the maximum acceptable starting ground rent would be 0.1 per cent of the property value with lending only available for leases of 125 years or more for flats, and 250 years or more for houses (although the changes would not apply to shared ownership properties).¹⁷
- 4.19 The Government recognises the challenges faced by existing leaseholders with 'onerous' ground rents. We are very keen to hear views on what steps could be taken to improve the situation of these leaseholders, which could include steps to tackle unreasonable and onerous rises in the future and strengthen the rights of consumer redress from unfair trading practices.

Questions:

Q13: What information can you provide on the prevalence of onerous ground rents? We are keen to receive information on the number and type of onerous ground rents (i.e. doubling, or other methods) and whether new leases are still being sold with such terms.

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 annual ground rent, and iii) how often the rate of increase could be applied to an annual ground rent? Please explain your reasons.

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

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

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

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

¹⁷ <http://www.nationwide.co.uk/about/media-centre-and-specialist-areas/media-centre/press-releases/archive/2017/5/05-protect-homeowners>

5. Exempting leaseholders potentially subject to 'Ground 8' possession orders

Amending the Housing Act 1988 so leaseholders are exempt from Ground 8 possession orders, originally intended to ensure assured tenants do not build up rent arrears

- 5.1 An unintended and unfair consequence of increasing levels of ground rents is that, where ground rents exceed £1,000 per year in Greater London and £250 per year elsewhere in England, leases are classed as an assured tenancy under the Housing Act 1988. This means that the landlord can seek to end the occupancy by an order of the court, and attempt to evict the tenant. Leaseholders may be unaware of the possible negative impacts of this. The Government is considering amending the Housing Act 1988 to exempt leaseholders from legislation that was intended to ensure that assured tenants in the private rented sector do not build up rent arrears.
- 5.2 The Housing Act 1988, as amended by the Housing Act 1996, lays down certain circumstances (grounds for possession) under which a landlord may successfully apply to court for possession. Grounds for possession fall into two categories: mandatory, where the tenant will definitely be ordered to leave if the landlord can prove breach of contract, and discretionary, where the court can decide one way or the other. Grounds for possession apply to tenancies entered into after 15 January 1989.
- 5.3 Ground 8 is particularly relevant as it covers mandatory grounds of possession for an assured tenancy as amended by the Housing Act 1996 and concerns arrears of rent. Where a leasehold is treated as an assured tenancy and ground rent is payable yearly, if at least three months' rent is more than three months in arrears then a landlord can automatically seek a possession order. The mandatory nature of Ground 8 means a judge cannot refuse to make the order.
- 5.4 The maximum arrears in each case must exist both at the notice of proceedings and at the hearing itself, and Ground 8 must be clearly stated so that the tenant/leaseholder knows what they are responding to. Although Ground 8 is unlikely to be used against leaseholders, should it be, leaseholders must ensure that where ground rent is paid yearly and arrears do not exceed three months at the time of the hearing.
- 5.5 We would like views on amending the Housing Act 1988 (as amended by the Housing Act 1996) to remove any opportunity for a landlord to seek a Ground 8 possession order against a leaseholder with an annual ground rent of over £1,000 in Greater London, or over £250 elsewhere in England, that has more than three months arrears of ground rent. This will rectify an unintended consequence of legislation, originally passed to ensure assured tenants in the private rented sector do not build up rent arrears, from applying to leaseholders and placing them at risk of possession.

- 5.6 Amending the Housing Act 1988 to exempt leaseholders from 'Ground 8' possession orders would not affect a landlord's ability to take legal action where a leaseholder has breached the terms of their lease, with forfeiture being the ultimate sanction available to a landlord. If the breach relates to arrears, a landlord cannot commence forfeiture proceedings where the amount of service charges, administration charges or ground rent owed (or a combination of all of these) total less than £350, or have been outstanding for less than three years.

Question:

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?

6. Service charges for maintaining communal areas and facilities on freehold and mixed tenure estates

Service charges for the upkeep of communal areas and facilities

- 6.1 Some private estates include both freehold houses and leasehold flats where households are expected to pay for the maintenance of communal areas and facilities. This can include payments for servicing of private roads, play areas for children and electric gates. A freeholder's contribution to the maintenance of communal areas and facilities is usually defined in the deed of transfer when the property was first sold by the developer.
- 6.2 There are several different ways to structure such an arrangement. The developer can set up a Residents' Management Company that owns the communal areas and facilities. The Residents' Management Company may upkeep the communal areas and facilities itself or employ a managing agent to act on its behalf. Alternatively, the developer can retain the ownership of the communal areas and facilities, and the responsibility for their maintenance. As in the case of a Residents' Management Company, the developer can carry out the maintenance directly or through a managing agent, who is accountable to the developer under the terms of the management contract. However, other approaches may be used to provide for the long-term management of shared areas and facilities. The issue we wish to address is whether under these legal arrangements the owners of freehold properties on freehold or mixed tenure estates have adequate rights to challenge unreasonable service charge demands.
- 6.3 Freeholders will usually have some rights under the arrangements in the deeds or in common law, but these may not be equivalent to the rights enjoyed by leaseholders under the terms of their leases and statute. Freeholders may also be able to bring pressure to bear indirectly. In cases where a Residents' Management Company is set up, the terms of the deeds of transfer may set out obligations that ensure individual freeholders have a say on the maintenance of communal areas. Where leaseholders on a mixed tenure estate have exercised the Right to Manage a freeholder wanting to challenge their service charge can try to convince the directors to act, or become a director of the Right to Manage Company.
- 6.4 The contrast between the positions of freeholders and leaseholders can be particularly clear where a developer retains the ownership of communal areas and facilities and the responsibility for their maintenance through a managing agent, or where a developer sells on the ownership of the communal areas and facilities to a private company.
- 6.5 In all these cases, even though freeholders may be paying for exactly the same services as leaseholders, they do not have a right to challenge the reasonableness

of service charges through the First-tier Tribunal (Property Chamber), which qualifying leaseholders can do.

- 6.5 The Government wants to promote appropriate rights for all freeholders living on private estates to challenge the reasonableness of service charges.

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?

7. Future issues

7.1 We set out in our White Paper *Fixing the Broken Housing Market* that we would “*take action to promote transparency and fairness for the growing number of leaseholders*” and the proposals in this consultation document are the first steps in achieving this. We will be looking ahead to further steps needed to ensure transparency and fairness, and considering the outcome of the Law Commission’s consultation on its 13th programme of law reform over the coming months which included residential leasehold. Our intention is for a wide ranging project. This will look at:

- improving commonhold,
- how managing agents operate
- leasehold terms and enfranchisement

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?

Annex A: Consultation Questions

To help us analyse the consultation responses, we would ask you to answer the following questions:

Q1: Are you responding as (please tick one):

- A private individual?
- On behalf of an organisation?

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

- An owner or tenant of a leasehold flat?
- An owner or tenant of a leasehold house?
- An owner of a freehold house?
- A private landlord?
- An individual with a portfolio of ground rents?
- Other? (Please specify)

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

- A residents' management company or right to manage company?
- A developer?
- An organisation representing leaseholders?
- An organisation representing freeholders?
- A lender?
- A solicitor / conveyancer?
- An estate agent?
- An organisation representing lenders?
- A supplier of management and/or other services to leaseholders?
- Other private landlord?
- A social landlord (either Registered Provider or local authority)?
- A developer of other housing tenures besides leasehold houses?
- A company that buys and sells ground rents?
- An investment company or pension fund that has a portfolio of ground rents?
- A local authority?

Other (please specify)?

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):

Limiting the sale of new leasehold houses

Q5: What steps should the Government take to limit the sale of new build leasehold houses?

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

- within a cathedral precinct;
 - on National Trust or Crown land;
 - on land owned by local authorities and university bodies with the right for future development;
 - in shared ownership with a 'restricted staircasing' lease;
 - of special architectural or historic interest or adjoining properties where it is important in safeguarding them and their surroundings.

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

Yes

No

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

Yes

No

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

No

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

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

- Yes
- No

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

Limiting the reservation and increase of ground rents on all new residential leases over 21 years

Q13: What information can you provide on the prevalence of onerous ground rents? We are keen to receive information on the number and type of onerous ground rents (i.e. doubling, or other methods) and whether new leases are still being sold with such terms.

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 annual ground rent, and iii) how often the rate of increase could be applied to an annual ground rent? Please explain your reasons.

i) initial annual ground rent -

ii) maximum rate of increase in annual ground rent -

iii) how often the rate of increase could be applied to an annual ground rent -

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

Yes

No

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

Yes

No

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

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

Exempting leaseholders potentially subject to ‘Ground 8’ possession orders due to their level of ground rent

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
- No

Service charges for maintaining communal areas and facilities on freehold and mixed tenure estates

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?

- Yes
- No

Future issues

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?

Annex B: What is a (leasehold) house?

What is a house?

The Leasehold reform Act 1967 Act gives a tenant of a leasehold house (and the premises that form a part thereof) a right to acquire the landlord's freehold interest on 'fair terms' (as determined by Part 1 of the 1967 Act, as amended primarily by the Leasehold Reform, Housing and Urban Development Act 1993 and the Commonhold and Leasehold Reform Act 2002).

Section 2(1) of the Leasehold Reform Act 1967 defines a house as including any building designed or adapted for living in and reasonably so called, notwithstanding that the building is not structurally detached, or was or is not solely designed or adapted for living in, or is divided horizontally into flats or maisonettes; and

- i) where a building is divided horizontally, the flats or other units into which it is so divided are not separate "houses", though the building as a whole may be; and
- ii) where a building is divided vertically the building as a whole is not a "house" though any of the units into which it is divided may be.

The Leasehold Reform Act 1967 (as amended) gives the tenant(s) of a house which they hold under a long lease the right to compulsorily acquire the freehold of the house from their landlord, provided the tenant(s) has/have owned the lease for two years, the building qualifies and subject to certain other conditions being met.

However, the 1967 Act adopts a flexible definition of a house stating it can include "...any building designed or adapted for living in and reasonably so called".

The House of Lords considered the case of *Tandon v Trustees of Spurgeon's Homes* (1982). In this case it was held that Parliament clearly intended the traditional situation of a shop on the ground floor with a flat on the first floor to fall within the definition of a 'house'.

In October 2012 the Supreme Court decision of *Day and another v Hosebay Ltd and Howard de Walden Estates Ltd v Lexgorge Ltd*¹⁸ focused on the definition of a house under the Leasehold Reform Act 1967. The properties concerned were originally built as houses but subsequently used as offices and a self-catering hotel. The Supreme Court decided that the original purpose and outward appearance of the buildings was not sufficient to make them houses for the purposes of the 1967 Act. Both properties were used entirely for commercial purposes and this use meant they could not be considered houses. Therefore properties solely in commercial use will not be able to obtain their freeholds or extend their leases under the 1967 Act. As a result of *Day and another v Hosebay Ltd and Howard de Walden Estates Ltd v Lexgorge Ltd*, if the building has the appearance of a house and is

¹⁸ <https://www.supremecourt.uk/cases/docs/uksc-2010-0152-judgment.pdf>

lived in as a residence, the s. 2(1) Leasehold Reform Act 1967 definition of “house” will be met. If, however, it is used wholly for business purposes it will not qualify.

In October 2015 the Court of Appeal clarified that the approach adopted in *Tandon v Trustees of Spurgeon’s Homes* in 1982 is correct. It decided in the case of *Jewelcraft Limited v Pressland*¹⁹ that a shop with a flat above was a house within the meaning of the leasehold reform Act 1967 (i.e. the two together constitute the house, not just the flat above alone). The court found that it was reasonable to call a building comprising a shop with residential accommodation above a house, even if the general public would normally describe it as a shop, even if the residential accommodation is not linked internally to the remainder of the building. The Court said that, in the future, neither the external appearance nor the internal layout of a building ought to make a difference in deciding whether a building is a house should it be the sort of building which, as a matter of policy, Parliament intended to fall within the 1967 Act.

¹⁹ <http://www.bailii.org/ew/cases/EWCA/Civ/2015/1111.html>

Annex C: About this consultation

This consultation document and consultation process have been planned to adhere to the Consultation Principles issued by the Cabinet Office.

Representative groups are asked to give a summary of the people and organisations they represent, and where relevant who else they have consulted in reaching their conclusions when they respond.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department for Communities and Local Government will process your personal data in accordance with DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Individual responses will not be acknowledged unless specifically requested.

Your opinions are valuable to us. Thank you for taking the time to read this document and respond.

Are you satisfied that this consultation has followed the Consultation Principles? If not or you have any other observations about how we can improve the process please contact us via the [complaints procedure](#).