

**Cambridge** Centre  
for Housing &  
Planning Research

# **Leasehold and Freehold Charges**

Appendix A:  
Desk based review

Dr Gemma Burgess  
Dr Katayoun Karampour

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Dr Gemma Burgess  
Cambridge Centre for Housing & Planning Research  
Department of Land Economy  
University of Cambridge  
19 Silver Street  
Cambridge  
CB3 9EP

[glb36@cam.ac.uk](mailto:glb36@cam.ac.uk)

Tel 01223 764547

[www.cchpr.landecon.cam.ac.uk](http://www.cchpr.landecon.cam.ac.uk)

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# 1. Introduction

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The aim of this review is to consider the existing information and evidence about service charges, administration charges, permission fees and freehold estate rentcharges. Reviewing literature about the charges that leaseholders and, in some cases, freeholders have to pay reveals that there is a lot of practice guidance available, some of which is very legalistic, but limited research. The existing literature highlights that this is a very complex area of both legislation and practice.

To have a better understanding of current discussions on service charges and other charges associated with leasehold properties and freehold estate rentcharges, publications and online information provided by key organisations are used in this research, e.g. the Leasehold Advisory Service (LEASE), the Royal Institution of Chartered Surveyors (RICS), the Association of Residential Managing Agents (ARMA), the Association of Retirement Housing Managers (ARHM), the Ministry of Housing, Communities and Local Government (MHCLG), the National Association of Estate Agents (NAEA) and the Competition and Markets Authority (CMA).

Statistics and surveys published by MHCLG, CMA, NAEA and Tpas provide an understanding of the size of the leasehold sector and some of the key issues. CMA's 'Residential property and management services, a market study' and the Housing, Communities and Local Government Select Committee's 'Leasehold Reform' report are also used in this research. The CMA's ongoing investigation into leasehold mis-selling may also provide useful insight into issues in the leasehold sector when it is complete.<sup>1</sup> Online magazines and newspaper websites (such as Which? and The Guardian) provided us with up-to-date news about the latest discussions relating to the research area. To understand the legal aspects of this area of research, in addition to searching government sites, we used Rosenthal et al's<sup>2</sup> book as a key source of information.<sup>3</sup>

This report looks firstly at different kinds of ownership and the various charges that leaseholders and freeholders are liable to pay. It then reviews the law relating to service charges, administration charges, permission fees and freehold estate rentcharges. Relevant case law is then briefly discussed. Section 5 summarises some of the key challenges discussed in the literature around the level of service charges, how they are calculated, what residents

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<sup>1</sup> CMA Leasehold mis-selling investigation, <https://www.gov.uk/cma-cases/leasehold>.

<sup>2</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional.

<sup>3</sup> Other sources of information about case law: Tanfield Chambers (Eds.), *Service charges and management*, 2018, 4<sup>th</sup> ed, London: Sweet & Maxwell; Sherriff, G, *Service charges for leasehold, freehold and commonhold*, 2007, Haywards Heath: Tottel.

think about them and what potential complications are. It then reviews relevant recommendations proposed by the Competition and Markets Authority<sup>4</sup> and the Housing, Communities and Local Government Select Committee<sup>5</sup>. The final section concludes the report by outlining the gaps in knowledge concerning the charges that leaseholders and, in some cases, freeholders have to pay.

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<sup>4</sup> CMA, Residential property management services: A market study, 2014.

<sup>5</sup> Housing, Communities and Local Government Committee, Leasehold Reform: Twelfth Report of Session 2017–19, 2019, London: House of Commons.

## 2. Definitions

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### 2.1. Types of ownership

There are two main ways of owning property in England and Wales: freehold and leasehold. Freehold means that one owns the land and the building that sits on it. This is usual for most houses, but can be found in some new build houses. Leasehold means that one has the right to occupy and use a flat or house, and to share the use of other areas of the building or estate, for a given number of years.

The patterns of property ownership, and of property rights, in blocks of flats can be complex. Some flats will be owned by owner-occupying leaseholders (including Right to Buy leaseholders), others by buy-to-let landlords, and yet others by housing associations and local authorities. The latter groups (housing associations and local authorities) will let their flats to tenants, either on short term lets as assured shorthold tenancies (as in the case of buy-to-let landlords), as assured tenancies in the case of housing associations, or, in the case of local authorities, as secure tenancies. Housing associations also sell flats and houses on long leases on shared ownership arrangements.

Commonhold was introduced in 2002 as a new way to own property. Commonhold enables a person to own the freehold of a "unit" (such as a flat) within a building or development and also become a member of a company which owns and manages the shared areas. To date, few commonhold properties have been established and the Government is looking at what more it can do to help support commonhold to get up and running to provide greater choice for consumers as an alternative to leasehold. The Government is currently working with the Law Commission to explore reforms to commonhold.<sup>6</sup>

#### 2.1.1. Freehold ownership

A freeholder, usually an individual or a company, owns the freehold title, i.e. the freeholder owns outright both the land that the building is on and the building itself. If a freeholder grants a lease, they become a landlord. The landlord is normally responsible for the upkeep of the property, although this may not apply for leasehold houses, which they may do themselves. Alternatively, they may appoint a property manager to perform their responsibilities on their behalf.

#### 2.1.2. Leasehold ownership

Leasehold is a form of property ownership whereby the purchaser ('the leaseholder') is granted exclusive occupation and use of the property for a period of time as set out in the lease. This may only be for a very limited number of years or for a longer period of time.

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<sup>6</sup> Law Commission, Commonhold.

However, ultimate ownership of the property remains with the freeholder, who is entitled to recover full ownership rights once the term of the lease has expired. The leaseholder may be permitted to grant a further lease (an 'underlease') to a third party for a shorter time period and become a landlord, but only to the person taking the underlease. In this review, unless otherwise stated, "landlord" is used to mean the person or company who is the freeholder.

The freehold of a leasehold property might be owned:

- by someone unconnected to the leaseholders (e.g. an individual, a company, a local authority and a housing association); or
- by the leaseholders (share of freehold).

### 2.1.3. The number of leasehold properties

Leasehold ownership is commonly used for flats, including those bought through Shared Ownership or Right to Buy, but sometimes houses are leasehold too.

MHCLG<sup>7</sup> estimates that in 2016-17, there were 4.3 million leasehold dwellings in England, which equates to 18% of the English housing stock. Of these, 2.3 million dwellings (54%) were in the owner-occupied sector and 1.7 million (40%) were privately owned and let in the private rented sector. The remaining 244,000 (6%) were dwellings owned by social landlords and let in the social rented sector. At the time of preparation of this report, these were the most up to date statistics; new data is expected to be published in September.

According to MHCLG's report, two thirds (67%, 2.9 million) of the leasehold dwellings in England were flats. However, proportions varied by tenure. In the private sector, 80% of flats were owned on a leasehold basis (90% of owner-occupied flats and 73% of privately rented flats).

33% (1.4 million) of the leasehold dwellings in England were houses. In the private sector, 8% of houses were owned on a leasehold basis (8% for the owner-occupied and 11% for private rented sectors respectively). In the social sector, 4% of houses were leasehold, although this varied depending on whether the house was owned by a housing association or a local authority. Less than 1% of local authority houses were owned on a leasehold basis, compared with 6% of houses owned by housing associations.

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<sup>7</sup> Ministry of Housing, Communities and Local Government, Housing Statistical Release: Estimating the number of leasehold dwellings in England, 2016-17, 2018, London: MHCLG.

	Houses		Flats		Total	
	% dwelling leasehold	Number of leasehold dwellings (thousands)	% dwelling leasehold	Number of leasehold dwellings (thousands)	% dwelling leasehold	Number of leasehold dwellings (thousands)
Owner occupied	7.6	1,015	90.1	1,293	15.6	2,308
Private rented sector	10.8	316	73.1	1,397	35.4	1,713
All private sector	8.2	1,330	80.4	2,690	20.5	4,021
Local authority	0.3	2	6.8	54	3.5	56
Housing association	5.6	74	10.2	114	7.7	188
All social sector	3.6	76	8.8	168	6	244
<b>All tenures</b>	<b>7.6</b>	<b>1,406</b>	<b>54.5</b>	<b>2,858</b>	<b>18</b>	<b>4,265</b>

Source: English Housing Survey; Land Registry; MHCLG Dwelling Stock Estimates 2016; VOA Council Tax Stock of Properties 2016  
Note: Percentages are rounded to one decimal place. Based on 11,233 cases.

**Table 1 Leasehold as a proportion of stock and number of dwellings, by tenure and dwelling type.<sup>8</sup>**

#### 2.1.4. The lease

This is the written contract between the freeholder and the leaseholder that gives the leaseholder the right to live in and use the property. The terms of the lease govern the relationship between the freeholder and leaseholder. The contract imposes mutual obligations on the parties, and sets out the details and conditions of the leaseholder's right to occupy the property.

The same lease is passed on every time a property is sold and the length of the lease continues to reduce. Leases can be extended and, under certain circumstances, leaseholders have rights to purchase an extension of the lease period. A premium will be payable to extend the lease. The cost of doing so will increase as the number of years remaining on the lease reduces. Leaseholders also can collectively purchase (in the case of flats) or individually purchase (in the case of houses) the freehold in certain circumstances.

#### 2.1.5. Responsibilities

The lease provisions set out the responsibilities of the landlord and the leaseholder. In leasehold flats, the landlord will usually be required to manage and maintain the structure, exterior and common areas of the property, to collect service charges from all the leaseholders, insure the building, and keep the accounts.<sup>9</sup> For leasehold houses, the landlord

<sup>8</sup> Ministry of Housing, Communities and Local Government, Housing Statistical Release: Estimating the number of leasehold dwellings in England, 2016-17, 2018, Page 5.

<sup>9</sup> Leasehold Advisory Service (LEASE), Living in Leasehold Flats – A guide to how it works.



may not be required to manage and maintain the structure, exterior and common areas of the property.

The leaseholder's obligations will include payment of the ground rent, if any, and contributions to the costs of maintaining, insuring and managing the building via a service charge. The lease may also place certain conditions on the use and occupation of the flat. Leaseholders may need the landlord's permission to make changes to or regarding the use of the property (e.g. carry out alterations, run a business from home, or keep a pet). A permission fee might be payable to cover the administrative, financial or time costs to the landlord of making a decision (e.g. consulting a surveyor regarding a proposed structural alteration to a building).

In some cases, freeholders of houses on private and mixed-tenure estates may have to pay estate rentcharges, the equivalent of service charges for leaseholders, for the maintenance of the estate's communal areas (e.g. roads and communal gardens).

#### 2.1.6. Residential property management

The landlord, or the leaseholders (through a residents' management company that is a party to the lease) may carry out the management of the maintenance and repair of their building themselves. Property management can, however, be a complex and time-consuming task, and raises significant liabilities and obligations. Often, and especially in larger developments, landlords will engage third party agents (property managers/managing agents) to carry out their management and maintenance duties.

Through this contractual arrangement, a property manager is empowered to carry out the landlord's management functions, including the calculation and collection of service charges from the leaseholders. Property management services are typically, but not always, provided by specialist property management agents.

Following the Commonhold and Leasehold Reform Act 2002, leaseholders of flats have the right to take over the management (i.e. to exercise the Right to Manage) of their building by setting up a Right to Manage Company (RTMCo). This does not apply to leasehold house owners, although the Law Commission are considering whether this right should extend to leasehold house owners as part of their current review of the legislation.<sup>10</sup> The company's members are leaseholders and, from the date on which the Right to Manage is acquired, can include landlords under leases of the whole or any part of the premises. The RTMCo can appoint any property manager of its choosing or even undertake management functions itself. The provisions and procedures relating to the Right to Manage (RTM) are discussed later in this report.

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<sup>10</sup> Law Commission, Right to Manage.

## 2.2. Charges

### 2.2.1. Service charges

Service charges, i.e. the ability of a landlord to recover the cost of services provided in relation to a property from a leaseholder, are generally used to ensure the maintenance of common parts and the structure of blocks of flats.

From the 1840s onwards, blocks of flats were developed for rent, firstly by charitable housing trusts and later by the private sector. Since the 1950s, flats and maisonettes have been developed for sale on long leases and, by the mid-1960s, landlords had begun the practice of granting long leases. The introduction of the Rent Act 1965 (which introduced regulated tenancies with independently set 'fair rents') and the Finance Act 1965 (which introduced corporation tax and capital gains tax) encouraged property companies to sell flats on long leases. However, it was in the 1970s that variable service charge provisions became more common for leased flats.<sup>11</sup>

The Landlord and Tenant Act 1985 defines a service charge as 'an amount payable by a tenant of a dwelling as part of or in addition to the rent which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord's costs of management, and the whole or part of which varies or may vary according to the relevant costs'. Relevant costs are actual or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charge is payable.

Subject to the lease, service charges for leaseholders may include such items as:

- cleaning and lighting of common parts;
- grounds maintenance of communal areas;
- provision and maintenance of lifts, entry phones, rubbish disposal, security lighting;
- fire alarms, communal aerials, etc.; and
- the landlord's costs of managing the services or an allowance for the costs.<sup>12</sup>

In addition, a lease usually requires a leaseholder to pay for items that would be a landlord's responsibility under the terms of a tenancy of less than seven years, such as:

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<sup>11</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional. Pages 4&5.

<sup>12</sup> Webb, R. and Hance, L. *Managing your Service Charges Effectively*, 2013, Coventry: HouseMark.

- repairs (and, if included in the lease, improvements) to the structure and common parts of the building; and
- insurance of the structure, common parts, public liability, etc.<sup>13</sup>

The lease should be explicit on the method of apportionment. Services may be charged at different levels with different rates of contribution. Whatever the method of apportionment used, it should be easy to administer.<sup>14</sup>

Most service charges are based on the actual or estimated cost of the services and thus vary from year to year. These are known as variable service charges. However, some older leases and tenancy agreements still provide for a fixed service charge to be levied and they are sometimes used in retirement leasehold properties.

A variable service charge does not mean that the landlord can vary the services, only the charge for them.<sup>15</sup>

Under the Landlord and Tenant Act 1985 and the Commonhold and Leasehold Reform Act 2002, when charging leaseholders, landlords should be aware that they should:

- charge a reasonable amount for services that are of a reasonable standard and are reasonably incurred;
- consult with leaseholders for major projects;
- deduct the amount of grant-aided works from the service charge; and
- make demands on time.

These requirements will be discussed below.

The Landlord and Tenant Acts 1985 and 1987 entitle leaseholders to challenge service charges that they feel are unreasonable at the First-tier Tribunal (Property Chamber).

### 2.2.2. Sinking (or reserve) funds

Leaseholders may be required to make additional contributions to a sinking (or reserve) fund to cover future major works (e.g. external decoration and replacement of the lift, boiler or roof) at the property at some future date, if the lease allows for the collection of a sinking or reserve fund. This enables the cost of major works to be spread over a number of years. As

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<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

with service charges, sinking fund contributions are subject to the same tests of reasonableness. Payments into these funds are held on trust by the payee, and the leaseholders are not entitled to any refunds on unspent money when they sell their property. New leaseholders can therefore benefit from accumulated past funds.

Although provision for a sinking fund is well established in the private housing market, it is not prevalent in social housing. In 2009, the Department for Communities and Local Government (DCLG) published a consultation paper which considered the possibility of local authorities establishing sinking funds to cover major works to leasehold properties.<sup>16</sup> The consultation paper concluded that, although the legislation does not prevent the operation of sinking funds, local authorities tend not to operate them for the following reasons:

- technical issues relating to Housing Revenue Account rules;
- early local authority leases do not provide for the operation of sinking funds;
- it is difficult to set contributions at a level that is both affordable and realistic in terms of meeting the costs of works;
- there is no guarantee of work being carried out as scheduled (some earlier sinking funds lapsed because leaseholders were reluctant to make further contributions after work was not carried out on schedule).<sup>17</sup>

### 2.2.3. Administration charge

Schedule 11 of the Commonhold and Leasehold Reform Act 2002 defines an administration charge as an amount payable by a leaseholders:

- for or in connection with the grant of approvals under the lease, or applications for such approvals;
- for or in connection with the provision of information or documents by or on behalf of the landlord or a person party to the lease other than the landlord or tenant;
- arising from non-payment of a sum due from the leaseholder to the landlord;
- arising in connection with a breach (or alleged breach) of the lease.

Some lease terms are intended to protect the freeholder's interest in a building, to enable efficient administration, and to protect other residents, and so approvals may be required

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<sup>16</sup> DCLG, Reform of council housing finance, 2009, London: DCLG.

<sup>17</sup> DCLG, Reform of council housing finance, 2009, London: DCLG. Page 29.

before leaseholders can undertake some activities, for example, subletting the property, making alterations to it, or keeping a pet.

Any administration charge that is neither (a) specified in the lease, nor (b) calculated in accordance with a formula specified in the lease, is known as a variable administration charge. Any variable administration charge demanded by the landlord must be reasonable in order to be payable. It must also be accompanied by a summary of the leaseholder's rights and obligations in respect of administration charges. If the summary is not included, the charge is not regarded as being payable unless, and until, the demand is made with the summary of rights and obligations.

#### 2.2.4. Permission fees

'Permission fee' is not a technical phrase, but is generally understood to be an amount payable by a leaseholder for the landlord's cost of dealing with applications for approvals or consents, for example, permission to remove an internal wall. In most cases, unless specified in the lease, permission fees fall into the administration charges category.

#### 2.2.5. Ground rent

The annual rent paid under the terms of a lease by the leaseholder of a house or flat to the landlord or freeholder of the land. The landlord or freeholder is not required to perform any services in exchange for payments. Based on the lease, the ground rent may:

- stay the same through the term of the lease;
- increase after a period; or
- increase according to a formula.

Ground rent is a source of income for the landlord or freeholder which is in addition to administration fees, commission on insurance, lease extension, and the sale of freeholds or subleases.<sup>18</sup> In the past, ground rent had been a nominal figure. However, there have been recent changes in the setting of ground rent terms by some developers, and related challenges regarding ground rents will be discussed in section 5.

#### 2.2.6. Rentcharges

There are two types of rentcharge. One, which resembles ground rent, is an annual sum paid by the resident freeholder to the owner of the rentcharge. This type of rentcharge is being phased out and can be removed on application.<sup>19</sup> The other type is an estate rentcharge,

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<sup>18</sup>CMA, Residential property management services: A market study, 2014. Page 73.

<sup>19</sup> Applicants can apply to the MHCLG Rentcharges team: <https://www.gov.uk/guidance/rentcharges>.

which resembles a service charge, and is paid by the freehold homeowner whose house lies within a private or mixed tenure estate. This amount may be used for the maintenance of common areas such as estate roads, drainage and other common areas.

Estate rentcharges are a common method of enforcing positive freehold covenants.<sup>20</sup>

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<sup>20</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional.

## 3. Legal frameworks

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The statutory framework for variable service charges has evolved over time, through a number of Acts of Parliament. The law has developed over time to match growth in the use of leasehold for flats and houses. There was no provision for a service charge until the 1970s. The Housing Finance Act 1972 (sections 90-91) was the first Act to give tenants the right to obtain a summary of costs from their landlord. The Housing Act 1974 (section 124) gave leaseholders who paid variable service charges the right to challenge the charge, and made provision for estimates to be obtained by landlords and for consultation to take place with tenants.<sup>21</sup> The Landlord and Tenant Act 1985, as amended by subsequent legislation, sets out basic ground rules for variable service charges, defining a service charge and setting out requirements for reasonableness and for prior consultation on major works.

### 3.1. Landlord and Tenant Act 1985

For leasehold residential variable service charges, the most important provisions are sections 18-30 of the Landlord and Tenant Act 1985. These controls apply to service charges, as defined in section 18 of the Act, in relation to dwellings, i.e. a building or part of a building intended to be occupied as a separate dwelling. It can apply to all residential properties.<sup>22</sup>

Section 18 of the Act defines variable service charges as follows:

*'Service charge means an amount payable by a tenant of a dwelling as part of or in addition to the rent: (a) which is payable for services, repairs, maintenance, insurance or the landlord's cost of management; and (b) the whole part of which varies or may vary according to the relevant costs.'*

Most importantly, in a residential context, section 19 of the Landlord and Tenant Act 1985 provides that such costs incurred by the landlord can only be recovered if they are reasonably incurred and the works or services are carried out to a reasonable standard. Under section 27A of the Act, a leaseholder can make an application to the First-tier Tribunal to consider the reasonableness of their service charges and their liability to pay them. There is no definition of reasonableness in the statute itself, but the RICS Residential Code<sup>23</sup> and the ARHM Code of Practice<sup>24</sup>, both of which are approved by the Secretary of State, can be relied

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<sup>21</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional. Pages 5&6.

<sup>22</sup> *Ibid.* Page 230.

<sup>23</sup> RICS, *Service charge residential management code and additional advice to landlords, leaseholders and agents*, 2016.

<sup>24</sup> ARHM, *Private Retirement Housing, Code of Practice England*, 2016.

on in court as part of the assessment of reasonableness, and therefore it is wise to comply with that code.<sup>25</sup>

The Act also imposes consultation requirements (section 20). Failure to comply with those requirements can have very serious implications for the landlord, as the landlord will be very limited as to the amount of costs that they are able to recover in relation to major or long-term works if the requirements are not complied with. This section of the Act was amended in 2002, and this will be discussed in more detail in the section 'The Commonhold and Leasehold Reform Act 2002'.

The Landlord and Tenant Act 1985 (section 20B) also imposes a time limit of 18 months from the date on which the relevant cost is incurred for making demands to recover payment of service charges. However, section 20B(2) says that, if the tenant was notified in writing that those costs had been incurred and that they would subsequently be required under the terms of their lease to contribute to them by the payment of a service charge, the 18-month rule shall not apply.

There are further controls contained in statute, but the consultation and reasonableness requirements are the most significant.

### 3.2. Landlord and Tenant Act 1987

The Landlord and Tenant Act 1987 made amendments to sections 18 - 30 of the Landlord and Tenant Act 1985 and also provides for the Right of First Refusal for flat owners but not house owners, as at the time of approval there were not many leasehold houses. Where a landlord is proposing to sell his interest in a building containing flats in relation to which the Right of First Refusal exists, he must first offer it to the leaseholders by serving formal notices before offering it on the open market. If the landlord sells without providing the Right of First Refusal, the leaseholders can serve a notice on the new owner demanding details of the transaction; they can then take action to force the new owner to sell to them at the price he paid.<sup>26</sup>

The Act also gives the leaseholders of flats, under certain circumstances, the right to apply to the First-tier Tribunal (Property Chamber) for the appointment of an independent manager, answerable to the Tribunal rather than to the landlord. This means that the landlord remains the same but the manager will be different. The right is not available where the landlord is a local authority or a housing association.<sup>27</sup>

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<sup>25</sup> Forcelux v Sweetman [2001] 2 EGLR 173, Wilkins v Forestcliff Management Ltd (LVT/SC1007/002/00). <sup>26</sup> LEASE, Right of First Refusal.

<sup>27</sup> LEASE, Appointment of a manager.



The Act enables leaseholders to acquire the freehold of their building where a landlord is in consistent breach of its management obligations over a period of time.<sup>28</sup> The Act also enables the leaseholder to seek a variation to the lease in certain circumstances by applying to the First-tier Tribunal (Property Chamber).

Section 42 of the Act provides that the recipient (the 'payee') of service charges holds those funds on trust. Sections 42A and 42B of the Landlord and Tenant Act 1987 requires leaseholders' contributions to be held in a designated bank account, and empowers leaseholders to inspect documents that evidence compliance with this requirement. However, this legislation has not been brought into force as concerns have been raised about administrative burdens and the costs of such requirements for managing agents or freeholders.<sup>29</sup>

Sections 47 and 48 of the Act also require that written demands made of a leaseholder must include the name and address of the landlord, and if that address is not in England and Wales, an address in England and Wales at which notices (including notices of proceedings) may be served on the landlord by the tenant. Where any demand for a service charge does not contain the required information, the amount demanded is to be treated as not being due from the leaseholder at any time before the information is furnished to them.<sup>30</sup>

### 3.3. The Leasehold Reform, Housing and Development Act 1993 and Housing Act 1996

The Leasehold Reform, Housing and Urban Development Act 1993 gives leaseholders the right to a management audit (section 76). This provision gives the leaseholders a right to appoint an auditor to examine the management practices of their landlord (e.g. to audit of the service charge accounts and to provide evidence for challenge of service charges at the First-tier Tribunal). The appointed auditor has legal powers to access the building and the landlord's accounts and other documents.

The Leasehold Reform, Housing and Urban Development Act 1993 also gives the Secretary of State power to approve codes of good practice in relation to the management of residential property. Two approved codes of practice are:

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<sup>28</sup> LEASE, Compulsory acquisition order.

<sup>29</sup> Regulation of Property Agents Working Group, 2019. Page 44.

<sup>30</sup> LEASE, Billing for service charges – a demanding task.

- Service Charge Residential Management Code, Royal Institution of Chartered Surveyors - applies to properties where a service charge is payable, and where the landlord is not a public sector body or a housing association;<sup>31</sup>
- The Code of Practice for Retirement Housing, Association of Retirement Housing Managers - applies to retirement housing provided by housing associations.<sup>32</sup>

The Leasehold Reform, Housing and Urban Development Act 1993 finally gives leaseholders the right, in certain circumstances, to buy their freehold, thereby allowing the leaseholders to take over control of their own service charges.

Under section 84 of the Housing Act 1996, residential long leaseholders who have formed a recognised tenants' association<sup>33</sup> have the right to appoint a surveyor to advise them on matters relating to service charges. Having access to information makes it easier for leaseholders to challenge unreasonable service charges.

### 3.4. The Commonhold and Leasehold Reform Act 2002

The Commonhold and Leasehold Reform Act 2002 introduced commonhold as a new form of tenure for new developments and for conversion of existing freeholds where the leaseholders involved agree to participate and buy out any freehold interest. A Commonhold Association is formed (whose members are freehold owners of their units of a building) to own and manage the common parts of the building.

The Act also introduced the Right to Manage (RTM) which enables leaseholders to take over the residential management functions of their building by setting up a Right to Manage Company (RTMCo). The RTMCo assumes full management responsibility for the residential aspects of the building and is free to appoint any property manager. Leaseholders do not have to establish fault on the part of the landlord or property manager in order to acquire the Right to Manage, but they must fulfil the following criteria before they can assume management responsibility through an RTMCo:

- the block must not have more than 25% (by internal floor area) as non-residential parts (for example, a block with a substantial share of retail premises would not be eligible);

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<sup>31</sup> RICS, Service charge residential management code and additional advice to landlords, leaseholders and agents, 2016.

<sup>32</sup> ARHM, Private Retirement Housing, Code of Practice England, 2016.

<sup>33</sup> A tenants' association is a group of tenants (normally leaseholders) who come together to represent their common interests.

- at least two-thirds of the flats must be owned by long leaseholders;
- the membership of the RTMCo must include long leaseholders accounting for at least half of the total number of flats contained in the building.<sup>34</sup>

Local authority leaseholders do not qualify for the RTM. Long leaseholders and tenants of local housing authorities can alternatively establish a tenant management organisation (TMO) and through that apply to take over the landlord's responsibility for managing housing services, such as repairs, caretaking, and security.<sup>35</sup>

The Commonhold and Leasehold Reform Act 2002, section 151, introduced new requirements for the statutory consultation of leaseholders. It replaced the old statutory consultation procedure (Landlord and Tenant Act 1985, section 20), but the title 'section 20' is retained. Detailed regulations (the Service Charges (Consultation Requirements) (England) Regulations 2003) have been enacted under section 151, which sets out the precise procedures that landlords must follow. To summarise, a landlord must comply with the consultation requirements if the contribution towards the cost of those works payable by any individual leaseholder exceeds £250. There are similar requirements for consultation on any long-term qualifying agreement lasting for over a year and worth over £100 a year.

In addition, there were new requirements for a landlord to state why they consider the works or the agreement to be necessary, and for further landlord statements setting out their response to observations received and their reasons for the selection of the successful contractor.

Consultation notices must be sent to both individual leaseholders and to any recognised tenants' associations (RTAs); both the leaseholders and the RTAs have a right to nominate an alternative contractor, and the landlord must try to obtain an estimate from such nominees.

The new procedures provide for two separate 30-day periods for leaseholders to make observations; landlords would be prudent to allow a minimum of three to four months for the whole process.

Two outline guides are available to explain the procedures in England and Wales for consulting lessees and tenants before entering into certain kinds of expenditure paid for from service charges:

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<sup>34</sup>CMA, Residential property management services: A market study, 2014. Pages 38&39.

<sup>35</sup> Law Commission, Leasehold home ownership: exercising the right to manage, 2019. Page 5.

- 'Section 20 Consultation for Council and other Public Sector Landlords', prepared by LEASE,<sup>36</sup>
- 'Consultation for Private Landlords, Resident Management Companies and their Agents', prepared jointly by LEASE, an independent body sponsored by MHCLG which provides advice to leaseholders, and the Association of Residential Managing Agents, (ARMA).<sup>37</sup>

These documents, which do not have statutory force, define and explain:

- qualifying works;
- qualifying long-term agreements;
- qualifying works under long-term agreements;
- some general rules about the procedures;
- the role of the First-tier Tribunal (Property Chamber) and dispensation;
- contracts requiring advertisement within the EU;
- duration and procedure of consultation; and
- penalty for non-compliance.

The Act also introduces various miscellaneous rights and obligations (amending parts of the 1985 Act) on the parties by way of amendment to other legislative provisions. This includes an obligation on the landlord to serve all service charge demands with a 'summary of rights and obligations'. It also gives rights to leaseholders to request a summary of expenditure.

### 3.5. The Social Landlords Mandatory Reduction of Service Charges (England) Directions 2014

These directions, known as 'Florrie's Law', limit service charges relating to the costs of repair, maintenance or improvement carried out wholly or partly with relevant assistance from a programme specified in the directions to £15,000 for a dwelling located within a London authority, and to £10,000 for a local authority dwelling located elsewhere in England, within any five-year period.<sup>38</sup>

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<sup>36</sup> LEASE, section 20 Consultation for Council and other public sector landlords.

<sup>37</sup> ARMA and LEASE, Consultation for Private Landlords, Resident Management Companies and their Agents, 2013.

<sup>38</sup> MHCLG, Florries Law, 2014.

According to the policy paper, these directions only apply when the works carried out by the social landlord are funded wholly or partly by:

- the Decent Homes Backlog Funding provided through the 2013 Spending Round; or
- any other assistance for the specific purpose of carrying out works of repair, maintenance or improvement provided by (i) any Secretary of State; or (ii) the Homes and Communities Agency.

### 3.6. Housing and Planning Act 2016

The Government introduced a package of measures in the Housing and Planning Act 2016 to increase transparency, fairness and efficiency for householders.

Section 131 of the Act amends Schedule 11 of the Commonhold and Leasehold Reform Act 2002 to give Courts and Tribunals, on application from a leaseholder, the discretionary power to restrict the ability of a landlord to recover the landlord's costs of taking part in legal proceedings as a variable administration charge from the leaseholder. Prior to 6 April 2017, the Courts and Tribunals were only able to restrict a landlord from recovering their legal costs through the service charge.

From 6 April 2017, leaseholders who are considering making an application for determination on a service charge bill, major works or a contract breach have been able to ask the courts to reduce or extinguish their liability to pay a particular variable administration charge in respect of litigation costs incurred, or to be incurred, by the landlord in connection with their court or tribunal proceedings. For landlords, this means that litigation costs, such as barristers' and solicitors' fees, cannot automatically be charged back to the tenant as a variable administration charge (should the lease so permit).

The new powers introduced by the Act do not apply in relation to litigation costs incurred, or to be incurred, in connection with any proceeding which began before 6 April 2017.

## 4. Case law review

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This section is a concise summary of the relevant case law relating to leasehold properties based on Rosenthal et al.<sup>39</sup> There are other legal books looking at case law relating to leasehold and freehold charges (e.g. Tanfield Chambers and Sherriff) which are not repeated here.<sup>40</sup>

Service charge disputes can be acrimonious, expensive, and unproductive:

*'As one who has practiced in the field of landlord and tenant law throughout his career and has seen a deal of service charge disputes, perhaps I may conclude by saying that this case contains many of the typical elements which cause and exacerbate disputes of this kind: first, a managing agent who did not regard it as part of his job to read the lease or give any consideration to whether the items, a contribution to the cost of which he was invoicing, properly fell within the service charge; secondly, a landlord who, despite earlier misgivings, appears to have decided to include all the costs of his project in the claim for service charges irrespective of the propriety of doing so, placing on his tenants the onus of challenging his demands if they were able to discover and disentangle the calculations on which they had been based; thirdly, a situation where the tenant had been led to expect a certain level of charge and then found himself being charged four times as much with no explanation being offered as to how this state of affairs had come about; leading, fourthly, to the tenant becoming so frustrated and alarmed that he dug in his heels, refused to pay and resolved to take every point going, good or bad, with a view to resisting what he regarded as his landlord's patently unjustified behaviour. A more potent recipe for expensive and unproductive litigation it would be difficult to devise.'*<sup>41</sup>

### 4.1. Interpretation of service charges

Very often, a service charge dispute can turn on the wording of a clause in the lease, and there are a number of factors which are taken into account by the court when interpreting a particular term. These include the factual matrix, i.e. an attempt to ascertain what was

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<sup>39</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional.

<sup>40</sup> Other sources of information about case law: Tanfield Chambers (Eds.), *Service charges and management*, 2018, 4<sup>th</sup> ed, London: Sweet & Maxwell; Sherriff, G, *Service charges for leasehold, freehold and commonhold*, 2007, Haywards Heath: Tottel.

<sup>41</sup> Per Jonathan Gaunt QC, sitting as a Deputy High Court judge in *Princes House Ltd v Distinctive Clubs Ltd* [2006] All ER (D) 117, [113].

objectively intended, and relevant background factors, such as whether the property is commercial or residential.<sup>42</sup> The court or tribunal will be concerned with identifying the intentions of the parties, by reference to 'what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean'.<sup>43</sup>

It does this by focusing on the meaning of the relevant words, in their documentary, factual and commercial contexts, and assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of the party's intentions.<sup>44</sup>

## 4.2. Maintenance and repair

There are three questions that the court will look to answer:

- is the leaseholder obliged to contribute to the cost of remedying the particular problem? (a question of interpretation of the lease);
- is the landlord entitled to charge for the remedial work which he has chosen to carry out? (usually a matter for expert evidence); and
- is it reasonable for the landlord to claim, as service charges, the cost of the work which is being undertaken and is the cost of that work reasonable?<sup>45</sup>

The court is frequently required to ascertain whether the building or part of the building concerned is covered by the service charge obligation.<sup>46</sup> It will then consider the precise wording of the obligation. For example, an obligation to meet the costs of 'repair' will normally only allow the landlord to recover costs for an aspect of the building falling into disrepair, not for one that was defective to begin with.<sup>47</sup> This can of course be a fine line, and the costs of 'renewal' or 'rebuilding' can go further than 'repair' where the item has deteriorated but was initially flawed.<sup>48</sup>

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<sup>42</sup> *Wembley National Stadium Ltd v Wembley (London) Ltd* [2007] EWHC 756.

<sup>43</sup> *Chartbrook Ltd v Persimmon Homes* [2009] AC 1101.

<sup>44</sup> *Arnold v Britton* [2015] UKSC 36.

<sup>45</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges, 2013, 3*, Haywards Heath: Bloomsbury Professional. Page 61.

<sup>46</sup> *Ibid.* Page 16.

<sup>47</sup> *Quick v Taff-Ely BC* [1986] QB 809.

<sup>48</sup> *Norwich Union Life Assurance Co Ltd v British Railways Board* [1987] 2 EGLR 137.

The tension between the landlord's obligation to maintain the property in good repair and the leaseholder's obligation to pay for this can produce some difficulty in determining the methods used to remedy any problems.<sup>49</sup> The general rule however is that it is ultimately for the landlord to decide which method should be used, provided that that method of complying with the relevant covenant is reasonable.<sup>50</sup> In determining reasonableness, the length of the lease is likely to be a relevant factor.<sup>51</sup>

### 4.3. Improvements

In addition to maintenance and repair, some leases allow the landlord to carry out improvement works, the cost of which can be recharged to the service charge fund. The law on improvement works can be complicated, especially if the works, or proposed works, overlap with or could be interpreted as maintenance and repair, not improvement works.

### 4.4. Heating and lighting

Typically, the leaseholder will be obliged to contribute to the cost of heating and lighting in the common parts. With such an obligation, the onus will be on the landlord to prove the amount of electricity and gas used.

### 4.5. Cleaning and refuse collection

This common obligation requires the leaseholder to contribute to the cost of keeping the common parts of a building clean. It is important that the lease defines which areas this applies to, e.g. outside windows, etc.

### 4.6. Costs of management

This obligation covers the time required to properly manage a building or development. Generally, the costs will be contractually recoverable as long as they were incurred in the performance of services already contained within the lease.<sup>52</sup> If the managing agent is unconnected to the landlord, it is unlikely that any issue will arise<sup>53</sup> but, if they are connected, a court will want to ensure that the arrangement is genuine and that the costs are properly

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<sup>49</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges, 2013, Haywards Heath: Bloomsbury Professional. Page 67.*

<sup>50</sup> *Plough Investments v Manchester City Council* [1989] 1 EGLR 244.

<sup>51</sup> *Fluor Daniel Properties Ltd v Shortlands Investments Ltd* [2001] 2 EGLR 103.

<sup>52</sup> *Wembley National Stadium Ltd v Wembley (London) Ltd* [2007] EWHC 756.

<sup>53</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges, 2013, Haywards Heath: Bloomsbury Professional. Page 91.*



incurred.<sup>54</sup> The RICS code recommends a fixed rate (rather than a rate linked to expenditure) for management fees.

## 4.7. Insurance

It is common for a landlord to be subject to an obligation to obtain insurance for the building, and for the leaseholders to reimburse that through the service charge. If the landlord takes out insurance beyond that mentioned in the lease, they will be unable to recover the entire cost of the policy.<sup>55</sup> If a landlord wishes to recover the entire cost of the insurance, it is therefore important to ensure that the insurance purchased falls squarely within what the leaseholder is obliged to pay for. This can sometimes conflict with the minimum building's insurance which a leaseholder's mortgage company may require, meaning that the building is not adequately insured.<sup>56</sup> Generally, the landlord is able to choose an insurance provider, even if it is not the cheapest insurance available, subject to the test of reasonableness.<sup>57</sup>

## 4.8. Operation of service charges

The detail of service charge operation will, of course, vary from lease to lease.

Leases will usually be either bipartite (landlord-leaseholder) or tripartite (landlord-leaseholder-management company). If a management company is used, the status of that company will be very important. For example, the management company may be leaseholder owned, in which case the leaseholders will have a dual role – as a member of the management company, a duty to perform the management company's covenants such as maintaining and repairing the building, and as a leaseholder, a duty to pay for those charges.

There are common problems with the operation of service charges. Firstly, there may be no provision in the lease for advance payments for sinking funds. The courts, generally, will not infer such an obligation and this may pose problems for a landlord without the necessary cash reserves to carry out the works.<sup>58</sup> A change of circumstances since the grant of the lease may also pose difficulties, e.g. an assignment of a lease where the service charge operation was drafted in such a way as to be personal to the landlord.<sup>59</sup>

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<sup>54</sup> *Skilleter v Charles* [1992] 1 EGLR 73.

<sup>55</sup> *Green v 180 Archway Road Management Co Ltd* [2012] UKUT 245 (LC).

<sup>56</sup> As set out in the UK Finance handbook.

<sup>57</sup> *Forcelux Ltd v Sweetman* [2001] 2 EGLR 173.

<sup>58</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges, 2013, Haywards Heath: Bloomsbury Professional. Page 187.*

<sup>59</sup> *St Modwen Developments (Edmonton) Ltd v Tesco Stores Ltd* [2007] 1 EGLR 63.

There are various methods by which a landlord may recover the costs of providing services, if service charges are not paid. The simplest method is to bring an action for a debt through the courts.

For a debt claim through the courts, the following conditions must be satisfied:

- there must be arrears outstanding under the lease;
- the leaseholder must be liable under the lease;
- the landlord must be the person entitled to sue on the debt;
- if the claim is brought against a former leaseholder, certain notice conditions must be met;
- the leaseholder must not be insolvent;
- the leaseholder must not have a valid set-off claim; and
- the action must be brought within the time limit.<sup>60</sup>

The monies must be correctly demanded by the landlord in line with all statutory obligations (such as providing the landlord's name and address for service).

For residential properties, it is also possible to apply for a determination from the First-tier Tribunal to assess the level of service charges that are payable;<sup>61</sup> this can then be enforced via a debt claim.

A further possible remedy is forfeiture for non-payment of service charges. In a claim based on forfeiture, the landlord must be able to show:

- one or more instalments of service charges are due;
- the leaseholder does not have a right of set-off;
- the lease must contain a right of re-entry for non-payment of a service charge;
- this right must not have been waived;
- the landlord must have served an appropriate notice (section 146 notice) and taken any other necessary preliminary steps. (In this respect, the Commonhold and Leasehold Reform Act 2002 and Housing Act 1996 provide that at least 14 days prior to the service of this notice, the landlord must have obtained either: (a) determination of the

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<sup>60</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges, 2013, Haywards Heath: Bloomsbury Professional. Page 351.*

<sup>61</sup> Landlord and Tenant Act 1985, section 27A.

service charges being recoverable from the First-tier Tribunal, (b) the leaseholder has admitted in writing that the service charges are owed, or (c) if there has been an arbitrator's award to that effect); and

- the landlord must bring appropriate court proceedings.<sup>62</sup>

Defences to claims based on forfeiture include a right of set off if, for example, the landlord has allowed the property to fall into disrepair, giving rise to a claim for damages. The leaseholder is also entitled to counterclaim for relief from forfeiture.

A landlord may seek to recover the costs of legal proceedings, also known as litigation costs, from the leaseholder if the lease permits it to do so, or if the landlord is able to recover them under the standard court rules.<sup>63</sup> If the leaseholder is unable to pay or there is a shortfall in the costs recoverable from that leaseholder, a lease may allow a landlord to recover the costs of legal proceedings from other leaseholders through the service charge.<sup>64</sup> A Court or Tribunal has the power to restrict the amount that can be recovered through the service charge (either by reducing it or extinguishing it altogether), and, as noted above, since 6 April 2017, they have had discretionary power to restrict the ability of a landlord to recover litigation costs through variable administration charges as well.

#### 4.9. Freehold covenants

There is a general rule that the burden of a positive covenant, e.g. to pay for the maintenance of common roads in an estate, cannot run with freehold land,<sup>65</sup> and under normal circumstances, a new freeholder is not bound by the obligations of a previous freeholder. There are, however, some indirect methods by which such burdens can be enforced. Firstly, and most simply, the contract with the original purchaser can be drafted such as to ensure a chain of promises.<sup>66</sup> Thus, the first freeholder will contract to ensure that a purchaser from them (a) agrees to be bound by the covenant and (b) to ensure that the purchaser agrees to include such a term in any onward conveyance. This will work until there is a break in the chain. Once the chain is broken, it will be very difficult to fix it. Of course, the last person to break the chain would be in breach of contract, but the remedy for such a breach may be insufficient.

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<sup>62</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional. Pages 393&394.

<sup>63</sup> Civil Procedure Rule 44.

<sup>64</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional. Page 114.

<sup>65</sup> *Keppell v Bailey* [1834] 2 My & K 517, 39 ER 1042; *Rhone v Stephens* [1994] 2 AC 310.

<sup>66</sup> Rosenthal, A., Fitzgerald, E., Duckworth, N., Radley-Gardner, O. and Sissons, P. *Commercial and residential service charges*, 2013, Haywards Heath: Bloomsbury Professional. Page 211.

Secondly, the acceptance of the burden of the covenant, e.g. to pay for the upkeep of an estate road, can be made a condition of being able to enjoy the benefit of it, e.g. driving over said road.<sup>67</sup> Thus it is possible to make such reciprocal obligations run with the land although the courts will be wary of such arrangements, interpreting the obligation and benefit as linked only where that is clearly the case.<sup>68</sup>

Thirdly, the landlord can reserve an estate rentcharge under the Rentcharges Act 1977 to cover the cost of providing services, carrying out maintenance and repairs, and insurance. This is an effective, but sometimes cumbersome, method. There is no obvious equivalent to the Landlord and Tenant Act 1985 as to the reasonableness of the cost, quality and recoverability of the cost of providing services to freehold properties, and any claims arising under the 1977 Act must be brought in court, rather than in the First-tier Tribunal.

The Law Commission has produced a report 'Making Land Work: Easements, Covenants and Profits à Prendre' which seeks to introduce a new concept of a 'land obligation' to allow obligations on freehold properties to run with the land of successive owners.<sup>69</sup>

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<sup>67</sup> *Halsall v Brizell* [1957] Ch 169.

<sup>68</sup> *Thamesmead Town v Allotey* [1998] 30 HLR 1052, [1998] EGLR 7.

<sup>69</sup> Law Commission, *Making Land Work: Easements, Covenants and Profits à Prendre*, 2011.

## 5. Existing challenges

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### 5.1. Leaseholders' satisfaction rate

A 2016 online survey of over 1,200 leaseholders conducted by the Leasehold Advisory Service (LEASE) found that 57% of leaseholders who responded said they regretted buying a leasehold property.<sup>70</sup> Dissatisfaction among those who bought a leasehold house is much higher. NAEA Propertymark surveyed over 1,100 house leaseholders in 2018, and showed that 94% of leasehold homeowners regretted buying a leasehold house and 93% of them would definitely not buy another leasehold property (NAEA Propertymark, 2018).<sup>71</sup>

According to the Leasehold Advisory Service online survey, the main source of dissatisfaction for leaseholders was related to the performance of their managing agent. Amongst the main findings, the survey identified that 57% of leaseholders said they regret buying a leasehold property, two-thirds of leaseholders don't feel they get a good service from their managing agent, just 6% are very confident the managing agent could resolve issues, and 68% of leaseholders have little or no confidence that their managing agent could resolve issues efficiently and effectively. According to the survey, 1 in 5 leaseholders are unaware that they could replace a poorly performing managing agent, 51% of leaseholders think that a change in managing agent would improve matters and benefit the block, but 55% of leaseholders consider changing managing agents would be a difficult process and 48% of leaseholders believe a lack of knowledge is a real barrier to changing managing agents. The survey found that 40% of leaseholders strongly disagree that service charge is value for money, and 62% of leaseholders say the service hasn't improved in the last two years. The survey identified that Residents' Management Company (RMC) directors are generally happier with their leasehold properties than 'ordinary' leaseholders due to a greater sense of control over the property's management and two thirds of RMC directors feel they have a good relationship with fellow directors and leaseholders, but identify a need for a strong, wide skill set beyond legal and company expertise. In terms of knowledge, the survey found that 55% of leaseholders know where to go for information but 32% definitely do not, and 52% of leaseholders are confident they know their rights and responsibilities.<sup>72</sup>

The CMA research looked at satisfaction levels of leaseholders in retirement properties and non-retirement properties. The research suggests that leaseholder satisfaction levels were greatest for those in retirement properties (82%) and those in non-retirement properties in private ownership (63%), but lower for those owned by local authorities (53%) or housing

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<sup>70</sup> LEASE, National Leasehold Survey 2016, 2016.

<sup>71</sup> NAEA propertymark, Leasehold: A Life Sentence? , 2018, Warwick: NAEA propertymark.

<sup>72</sup> LEASE, National Leasehold Survey 2016, 2016.

associations (53%). Results were notably different for properties where there was either a Right to Manage Company (RTMCo) or an RMC arrangement in place; for such leaseholders, overall satisfaction was high with eight in ten rating services as good (83%) compared with just over a half (58%) for non-RTMCo/RMC leaseholders. While half of leaseholders (52%) agreed that their property manager provided value for money, this rose to nearly eight out of ten (78%) among RTMCo/RMC leaseholders.<sup>73</sup>

The Select Committee's recent report<sup>74</sup> reports that most of the complaints they received were from leaseholders of new build properties. Most of these leaseholders were dissatisfied and thought that they had been treated by developers, freeholders and managing agents, not as homeowners or customers, but as a source of steady profit. However, developers and freeholders argued that the leasehold sector is working well and that dissatisfied leaseholders are not representative of the wider leasehold sector.

Although a new form of tenure, commonhold, was introduced in the Commonhold and Leasehold Reform Act 2002, fewer than 20 commonhold properties have been registered, most of which are of a very small scale.<sup>75</sup> In 2017, the Government asked the Law Commission to propose reforms 'to re-invigorate commonhold as a workable alternative to leasehold, for both existing and new homes' as part of their Thirteenth Programme of Law Reform.<sup>76</sup> The Law Commission published a consultation paper in December 2018 which sought to address the legal issues within the current legislation.<sup>77</sup>

## 5.2. Levels of service charges

Preliminary consideration of the English Housing Survey (EHS) leasehold data for 2013-14 shows that the mean amount for service charge was £1,185.60 per year.<sup>78</sup> Direct Line for Business research claims that the service charges for new build developments are much higher than older ones and are, on average, £2,777 per year, which is 96 per cent higher than older properties, mainly due to extra amenities that new developments offer (e.g. 24 hour concierge services).<sup>79</sup>

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<sup>73</sup> CMA, Residential property management services: A market study, 2014. Page 9.

<sup>74</sup> Housing, Communities and Local Government Committee, Leasehold Reform: Twelfth Report of Session 2017–19, 2019, London: House of Commons.

<sup>75</sup> Ibid. Page 14.

<sup>76</sup> MHCLG, Written evidence submitted by the Ministry of Housing, Communities and Local Government [LHR 548], 2018.

<sup>77</sup> Law Commission, Reinvigorating commonhold: the alternative to leasehold ownership, 2018.

<sup>78</sup> These figures are based on CCHPR's calculation.

<sup>79</sup> Direct Line for Business, Property pain: service charges increasing rapidly, 2016.

Evidence suggests that many leaseholders have concerns about high and escalating service charges.<sup>80</sup> Direct Line for Business research claims that service charges have been rising rapidly with a third (33 per cent) of management companies increasing these fees between 2014 and 2016.<sup>81</sup>

LEASE Open Data shows that, between 2014 and 2019, service charges have been the key issue that customers have raised with LEASE (29% of enquiries relating to service charges).<sup>82</sup> The 2016 survey from the same organisation found that 40% of leaseholders 'strongly disagreed' that service charges represented value for money.<sup>83</sup>

An older survey<sup>84</sup> of the cost of living in affordable high density mixed tenure developments drew attention to high service charges, making some schemes relatively expensive to live in. Gross rents in some London schemes were equivalent to over 30 per cent of net income. Service charges were most often complained about by low cost home ownership respondents.

In 2012, the London Assembly published 'Highly Charged', a report looking into London's leasehold sector.<sup>85</sup> The majority of leaseholders were reportedly in the private sector, but there were significant numbers of leaseholders with social landlords, often as a result of the Right to Buy. The report identified a general trend for service charges to increase over time. From the adjudication and dispute resolutions handled through the Leasehold Valuation Tribunal Service, the GLA found that service charge related cases in London increased by more than 54 per cent between 2005 and 2010. Overall, the GLA estimated that Londoners paid more than half a billion pounds in annual service charges.

Tpas's leaseholder survey<sup>86</sup> reported that respondents completing the online survey expressed high levels of dissatisfaction with various aspects of service charges and their experiences of repairs:

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<sup>80</sup> Housing, Communities and Local Government Committee, Leasehold Reform: Twelfth Report of Session 2017–19, 2019, London: House of Commons.

<sup>81</sup> Direct Line for Business, Property pain: service charges increasing rapidly, 2016.

<sup>82</sup> LEASE, Open Data from the Leasehold Advisory Service.

<sup>83</sup> LEASE, National Leasehold Survey 2016, 2016.

<sup>84</sup> Bretherton, J. and Pleace, N., *Residents' Views on New Forms of High Density Affordable Living*, 2008. York: Joseph Rowntree Foundation and Chartered Institute of Housing.

<sup>85</sup> GLA, *Highly Charged: Residential Leasehold Service Charges in London, 2012*. London: Greater London Authority.

<sup>86</sup> Tpas and Newbolt, K, *Leasehold Engagement: Best Practice Research Outcome*, 2014.

- 57 per cent of all respondents were unhappy or very unhappy with how their housing provider communicated with them about annual service charges;
- 59 per cent of all respondents were either dissatisfied or very dissatisfied with the information provided about the most recent major works;
- 61 per cent of all respondents were either dissatisfied or very dissatisfied with the breakdown of costs provided;
- 52 per cent of all respondents were either dissatisfied or very dissatisfied with the way they were billed for works; and
- 61 per cent of all respondents rated the way their housing provider consulted with them over the most recent works as poor or very poor.

The highest levels of dissatisfaction were expressed by respondents who had experienced major works at their property, those paying higher service charges, and owner-occupiers. To some extent, this confirms the view that leaseholders generally tend to resent having to pay service charges and this tendency is increased as charges are higher and less predictable with a lower standard of service.<sup>87</sup>

Of the complaints received directly by the CMA, the greatest number were related to the level of service charges, with 52% mentioning excessive or unnecessary charges, and 22% mentioning a lack of transparency in how charges are calculated.<sup>88</sup>

### 5.3. How service charges are calculated

Legislation and case law have developed piecemeal over the years, resulting in a patchy framework on which to establish which services could be the subject of charges. There is no formal guidance available to define how service charges should be calculated. However, all service charges must be calculated in the manner provided for in the lease and it is standard practice to use the actual expenditure from the preceding year as a starting point for working out the budget.

Different industry guidance notes have been developed for reference and to minimise the risk of legal challenge. In 'Service charges, a guide for housing associations', Mezac and Hardman<sup>89</sup> explain how service charges should be calculated for tenants and leaseholders of housing associations in order to avoid future disputes. The guide says that service charges

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<sup>87</sup> Tpas and Newbolt, K, Leasehold Engagement: Best Practice Research Outcome, 2014. CMA.

<sup>88</sup> Residential property management services: A market study, 2014. Page 60.

<sup>89</sup> Mezac, P. and Hardman, E., *Service Charges, A guide for housing associations*, 2015, 5th ed. London: NationalHousing Federation.



should be calculated before the beginning of the account year, according to the terms of the lease. These calculations have to include the following three main items:

- estimated expenditure;
- contributions to the reserve;
- an assessment of the existing reserve funds.<sup>90</sup>

To estimate expenditure, the landlord will need to include the estimated costs of maintenance and repairs which may be incurred by the landlord, costs of insurance, costs involved in complying with any notices or regulation, fees, charges and expenses payable to authorised persons (e.g. solicitor, accountant and surveyor), water rates and administration charges. To calculate the amount of the reserve fund (if the lease allows for a reserve or sinking fund to be set up), the landlord may commission a one-off survey from a third party to establish the life cycle of the components of the building, or use former years' figures.<sup>91</sup>

There is no accepted norm for the apportionment of costs between different types of units. Some landlords charge a flat rate per unit, irrespective of its type or size; some apportion costs by square metre of floor area, others by the number of bedrooms in the unit or its occupancy.<sup>92</sup> The apportionment will also depend on the terms of the lease. Furthermore, there is no accepted norm for the apportionment of costs between different tenures (shared ownership leaseholders, social/affordable housing tenants, etc.) living in the same development. Some landlords deliver different levels of service to different tenures, and this is reflected in the service charges to residents of those tenures.<sup>93</sup> In these cases, different tenures are mostly accommodated in separate blocks. However, a contrary argument is that this social segregation is a pragmatic approach to minimise housing costs for those on lower incomes.<sup>94</sup>

It is not uncommon in mixed tenure developments to see a service charge of £15 per week for social/affordable rent tenants and of £40 for shared owners.<sup>95</sup> The apportionments between different types of units are subject to reasonableness, and reasons for discrepancies with the percentages must be justifiable.

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<sup>90</sup> Ibid. Page 66.

<sup>91</sup> Ibid. Pages 67&68.

<sup>92</sup> Jones, M., *High Density Housing – The Impact on Tenants: A Review of Service Charges*, 2010. London: East Thames. Page 18.

<sup>93</sup> Three Dragons *et al.*, *Lessons from Higher Density Development*, 2016. London: Greater London Authority. Page 36.

<sup>94</sup> Ibid. Page 77.

<sup>95</sup> Ibid. Page 36.

There is also wide variation in the life expectancies applied to different building elements (sometimes by the same landlord), with the 'life' of lifts ranging from 10 years to 25 years, and of water pumps ranging from 10 years to 30 years. The cost of individual charges for relatively standard items such as utilities, entry phones or administration can vary widely, and not all items with similar life expectancies, such as windows or roofs, are treated in the same way.<sup>96</sup>

## 5.4. Managing agents

The CMA estimated that there are 3.1 million leasehold flats in England and Wales which might receive residential property management services, although some will self-manage. There are many property managers in England and Wales, but no national register of such companies exists. There are many small and local companies, far fewer regional companies, and only a very few large and national operators.<sup>97</sup>

The CMA leaseholder survey indicated that many leaseholders are satisfied with the service and value for money they receive, and satisfaction rates were higher than those in the Leasehold Advisory Service online survey<sup>98</sup>, although CMA also found that leaseholders in properties with an RTMCo/RMC have higher levels of satisfaction. They asked respondents to what extent they agreed or disagreed with the statement that their property manager provided value for money. 52% of respondents agreed that they got value for money, and 28% disagreed that their property manager provided value for money, with half saying they strongly disagreed. Levels of agreement were highest among those with an RTMCo/RMC (78%) and those in retirement properties (69%). 52% of those living in private developments agreed, as did 45% of those living in housing associations and 40% in local authority developments.<sup>99</sup> The difference in satisfaction rates between the CMA survey and the Leasehold Advisory Service online survey is likely to reflect differences in the sample and the questions asked.

The CMA report found that the quality of service and the level of satisfaction depended to a large extent on the quality of individual managers and the nature of the relationship between leaseholders and the individual property manager. Some property managers were seen as less competent or scrupulous than others.<sup>100</sup>

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<sup>96</sup> Jones, M., High Density Housing – The Impact on Tenants: A Review of Service Charges, 2010. London: East Thames.

<sup>97</sup> CMA, Residential property management services: A market study, 2014. Page 6.

<sup>98</sup> LEASE, National Leasehold Survey 2016, 2016.

<sup>99</sup> CMA, Residential property management services: A market study, 2014. Pages 59&60.

<sup>100</sup> Ibid. Page 6.

Where issues arose, the research found that they encompassed a wide range of issues including quality of service, value for money and the ability to obtain redress. Moreover, where the relationship between property manager and leaseholder breaks down, the impact on leaseholders can be very significant.<sup>101</sup>

They also found that once a property manager has been appointed, the tendency to switch is low. Where switching does occur, it is mainly motivated by significant leaseholder dissatisfaction with the current property manager's performance.<sup>102</sup>

The research concluded that practices on the provision of information by property managers varied, and examples of poor, incomplete or confusing information were identified. However, the research also found that many property managers engaged constructively with leaseholders, and identified examples of comprehensive and readily accessible information provided to leaseholders.<sup>103</sup>

## 5.5. Escalating ground rent

In modern leases, the average ground rent is thought to be around £370 per year,<sup>104</sup> with rent review clauses enabling the rents to rise, usually in line with inflation, at the points specified. In this recent era of modern ground rents, some developers introduced ground rent terms whereby the initial rent doubled every 10 years as opposed to rising in line with inflation.

Unlike service charges, there is no legislation for the regulation of ground rents, enabling landlords to increase the ground rent based on lease terms. Some housebuilders<sup>105</sup> have used doubling ground rent clauses, reported in the media as putting leaseholders in a very difficult financial position. Besides the increased payment liability after the review period, the marketability and mortgageability of leaseholders' properties have been reported to be reduced as a result of significantly increased ground rent.<sup>106</sup> In response to media and government pressure, some housebuilders have offered leaseholders a new arrangement in which they can convert their ground rent terms to an RPI (Retail Price Index)-based structure.<sup>107</sup>

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<sup>101</sup> Ibid. Page 10.

<sup>102</sup> Ibid. Page 11.

<sup>103</sup> Ibid. Page 11.

<sup>104</sup> The Guardian, Radical plans to end huge costs of buying a freehold unveiled, 2018.

<sup>105</sup> Which?, To have or to leasehold? Inside the scandal rocking the new homes industry, 2018.

<sup>106</sup> The Guardian, Government promises to stamp out abuses of new-build ground rent scandal, 2016.

<sup>107</sup> The Guardian, Taylor Wimpey: most buyers in ground rent scandal will be able to get new deals, 2017.

The NAEA survey of house leaseholders shows that almost half (45%) say they were unaware of the escalating ground rent of their leasehold houses.<sup>108</sup> It also found that it is reasonably common for ground rent terms to begin from the point at which a property is under construction – or even as early as the point at which the deal for construction is signed off. This means some leaseholders may experience increases in ground rent while they, as the first owners of the property, have not yet reached the 10-year point.

In December 2017, in order to address issues around ground rent, the Government announced it would tackle unfair practices in the leasehold market by introducing legislation to prohibit new residential long leases from being granted on houses, other than in exceptional circumstances, and to restrict ground rents in newly established leases of houses and flats to a nominal amount.<sup>109</sup> In June 2019, the Government concluded a six week consultation to seek views on appropriate exemptions, such as shared ownership properties and community-led housing. The Government announced in this report the restricting of ground rents on newly established leases to a peppercorn (zero financial value) level.<sup>110</sup>

The Government also asked the CMA to investigate escalating ground rents for existing leaseholders. The CMA published their initial report on 28 February 2020. Of new build residential properties sold during 2000-2018 (c1.9m), the report identified around 21,000 that were sold with a doubling escalation, of which, 13,000 had review periods of 10 or 15 years. Based on this information, they estimated that the total number of properties with 10-year or 15-year doubling clauses is about 18,000.<sup>111</sup>

## 5.6. High permission charges

High permission fees have also been reported by some leaseholders. Landlords and/or management companies (depending on the terms of the lease) can charge for various administrative tasks and approvals, including approvals to keep pets, sublet the property or to make structural alterations. Schedule 11 of the Commonhold and Leasehold Reform Act 2002 provides some regulation of the amount that can be charged, but there is no regulation in place setting a maximum amount that freeholders can charge for a permission fee. As reported by Which?, the flat fee to respond to a letter could range from £50 to £108, permission to build a conservatory could be as high as £2,500, and to have a pet could cost £252.<sup>112</sup>

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<sup>108</sup> NAEA propertymark, Leasehold: A Life Sentence?, 2018, Warwick: NAEA propertymark.

<sup>109</sup> MHCLG, Crackdown on unfair leasehold practices, 2017.

<sup>110</sup> MHCLG, Government response to the Housing, Communities and Local Government Select Committee report on Leasehold Reform, 2019.

<sup>111</sup> CMA, Leasehold Investigation Update Report, <https://www.gov.uk/cma-cases/leasehold>, p25.

<sup>112</sup> Which?, To have or to leasehold? Inside the scandal rocking the new homes industry, 2018.

CMA's research found that these charges sometimes seemed high and disproportionate to the work required. It found that, although some property managers publicised their charges in advance, often the existence or size of charges came as a surprise to leaseholders, and they were unlikely to be considered when tendering for the appointment of a property manager.<sup>113</sup> The CMA is currently investigating this issue.<sup>114</sup>

The NAEA survey of house leaseholders shows that awareness of these costs is low among buyers and the majority (75%) were not expecting to be charged to make alterations to their property.<sup>115</sup> These leaseholders were charged an average of £1,597 for permission for an extension (e.g. conservatory), £1,472 to install new bathroom fittings and £1,348 to make structural changes.

## 5.7. One-off bills for major works in social sector

All social landlords were required to bring their stock up to the Decent Homes Standard by 2010. Although funding for this programme has largely ended, social landlords are still required to carry out works to maintain their stock. As local authorities do not operate a sinking fund, this can result in leaseholders receiving substantial bills in respect of their contribution towards the cost of this work. In response, in 2014, the Government brought in a cap on service charges for social sector leaseholders which applies only where the work is carried out with central Government funding.<sup>116</sup> The recent Select Committee reported that high one-off bills can continue to be a concern for leaseholders in both the social sector and private sectors.

## 5.8. Commissions

The CMA were told by both leaseholders and property managers that commissions on buildings insurance could be very high (in some cases, more than 40% of the premium). They found that this could result in high charges to leaseholders. The RICS Code of Practice recommends disclosure of commissions associated with insurance policies as good practice but it is not mandatory. Leaseholders can challenge the reasonableness of such charges but poor transparency and inadequate disclosure provisions under the existing regulatory regime make this difficult for leaseholders to assess.<sup>117</sup>

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<sup>113</sup> CMA, Residential property management services: A market study, 2014. Page 11. CMA,

<sup>114</sup> CMA launches consumer law investigation into leasehold market, 2019.

<sup>115</sup> NAEA propertymark, Leasehold: A Life Sentence?, 2018, Warwick: NAEA propertymark.

<sup>116</sup> Wilson, W., Leaseholders in social housing: paying for major works (England), 2015.

<sup>117</sup> CMA, Residential property management services: A market study, 2014. Page 12.

## 5.9. Lack of shared space adoption leading to estate rentcharges

As mentioned previously, the estate rentcharge is part of a positive covenant which will not automatically pass as a matter of law to the next purchaser. This may create legal challenges for an estate manager wishing to recover those charges. The NHBC Foundation commissioned research to investigate the circumstances and consequences of performance bonds required by highways authorities and water supply companies for housing developments.<sup>118</sup> This section reflects on the findings, because they relate to the growth in the use of estate rentcharges.

The legal framework that governs highways and sewer adoption is complex and has developed in a piecemeal manner over time. Some aspects of provision and adoption are governed by legislation but most are determined by local policy and practice.<sup>119</sup> The adoption of highways, water and sewer mains is a well-established process: road and sewer bonds are a guarantee on behalf of a property developer (including house builders) that they will complete the roads and sewers to the required standard and within a defined time frame to enable them to be adopted by the appropriate authority under the relevant Acts of Parliament. Bonds overrun for a variety of reasons, but the main reason is a lack of incentive for house builders to return to old sites to complete remedial works and a lack of incentive for local authorities to call in bonds to undertake the works themselves. In these cases, roads remain unadopted. The research found that many people do not realise their road has not actually been adopted by the local authority and complain to the local authority about repair work.<sup>120</sup>

However, the research also found that roads may be deliberately unadopted and passed to a management company who will raise an estate rentcharge to cover the costs of upkeep.<sup>121</sup> In some cases, particularly apartment developments, private unadopted estate roads may be constructed which do not require a bond. Many house builders have experience of providing unadopted roads. This can be because the development has certain features that the local authority would not want to take responsibility for, such as electric gates, or a complex street network with, for example, a large number of cul-de-sacs. Permitting roads to remain unadopted allows developers the flexibility to build in a way that local authorities would not allow for adoption, such as narrower road widths or shared access arrangements. Some developments have a degree of prestige from certain features such as gated roads which are not adopted, and house builders have said that residents are happy to pay towards their

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<sup>118</sup> Burgess, G. and Jones, M., *Road and Sewer Bonds in England and Wales – report to the NHBC*, 2014. Cambridge: Cambridge Centre for Housing and Planning Research.

<sup>119</sup> *Ibid.*

<sup>120</sup> *Ibid.*

<sup>121</sup> *Ibid.*

upkeep.<sup>122</sup> On occasion, the research found, management of such arrangements is not transferred to a management company but remains the responsibility of the owners.

The research found that house builders do not find it difficult to set up a management company or to arrange a maintenance contract where roads and infrastructure remain private. However, local authorities said that they can encounter problems as schemes age or management arrangements lapse, as residents then look to the local authority for repairs for which they are not technically responsible.<sup>123</sup> In some cases, authorities reported that, over time, residents may have not maintained the upkeep of unadopted roads, and then turn to the local authority when works become necessary.<sup>124</sup> Overall, the report on road and sewer bonds concluded that the current system appears to offer poor protection for the consumer, with roads remaining unadopted for years, creating problems when repairs are needed, and there is no clear picture of responsibility.<sup>125</sup> This research on road bonds sheds light on one reason why estate rentcharges might have become more prevalent on new build developments in recent years.

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<sup>122</sup> Ibid.

<sup>123</sup> Ibid.

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

## 6. Sector recommendations

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### 6.1. The Competition and Markets Authority's recommendations

The Competition and Markets Authority (CMA)<sup>126</sup> made a series of recommendations to improve:

- prospective purchasers' awareness of leaseholders' obligations;
- disclosure, transparency and communication between property managers and leaseholders; and
- leaseholders' access to appropriate forms of redress.

In terms of pre-purchase remedies, the CMA recommended that when specific enquiries are made about property, the estate agent should provide a short information sheet providing key information with key facts about leasehold ownership. They also recommended that leasehold property particulars prepared by estate agents should state the current level of service charges, and that a requirement to provide this information should be incorporated into the approved code of practice followed by estate agents and the associated guidance that supports it.<sup>127</sup>

The CMA recommended that remedies to improve transparency and communication are addressed through an update of the self-regulatory industry codes of practice, to include (for each property managed):

A clear statement of:

- purpose and responsibilities of the property manager;
- property management plans and strategy;
- key information relating to past work; and

disclosure of:

- what is included within the core management fee and rates of management charges;
- administration and supplementary charges;
- commissions (including commissions earned by the property manager for arranging the buildings insurance);
- full disclosure of corporate links; and

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<sup>126</sup>CMA, Residential property management services: A market study, 2014.

<sup>127</sup> Ibid. Page 20.



- recognition and encouragement of better property management communication.

There were two remedies recommended by CMA that require regulatory or legislative change:

- new legislation to give leaseholders rights to trigger re-tendering and rights to veto the landlord's choice of property manager;
- review of section 20 and the regulations made under it (consultation with leaseholders in relation to major works) to ensure that it does not impose unnecessary costs on all parties and delay necessary works.

The CMA report also made specific recommendations for local authorities and housing associations to:

- share best practice in working with leaseholders; and
- identify leaseholder costs by block.

The last remedy of the report (redress remedies) recommends the provision of cheaper and quicker alternatives to taking claims to the First-tier Tribunal. It suggests that the provision of either independent advice to the parties about the merits of their case, or some form of alternative dispute resolution (either early neutral evaluation, mediation, or similar) would be appropriate.

## 6.2. Implementation of the CMA's recommendations

In response to the recommendations of the CMA's report, actions have been taken by a number of stakeholders.<sup>128</sup>

In response to pre-purchase remedies, LEASE has produced information sheets for prospective purchasers which are available on their website:

- a one-page information sheet for prospective purchasers,<sup>129</sup> which briefly explains freehold and leasehold forms of ownership, with some brief but useful explanation of terms;
- a more detailed two-page information sheet,<sup>130</sup> elaborating further on the difference between freehold and leasehold ownership. It also explains common terms such as:

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<sup>128</sup> CMA, Implementation of the CMA's recommendations, 2016.

<sup>129</sup> LEASE, Things to know before you buy a flat.

<sup>130</sup> LEASE, Thinking of buying a flat?

lease, ground rent, managing agent, reserve or sinking fund, residents' association, service charge and share of freehold.

The Property Ombudsman has amended its Code of Practice for Residential Estate Agents to require estate agents to provide basic key information (such as service charges, ground rent and the length of years remaining on the lease) for prospective purchasers.

Leasehold Property Enquiries Form 1 (LPE1) has been revised to offer a standard set of questions to be used as part of the conveyancing process. These aim to ensure that the prospective leaseholder has sufficient information on which to make an informed purchase decision. In addition, a buyers' Leasehold Information Summary (LPE2) has been introduced to improve the information given to buyers of leasehold property about their financial obligations as a leaseholder.<sup>131</sup>

A number of remedies designed to improve transparency and communication have been addressed via self-regulatory industry codes of practice:

- the CMA findings and recommendations have informed the Ministry of Housing, Communities and Local Government's (MHCLG) review of the two Statutory Codes of Practice. In 2016, the Secretary of State approved updates to the Association of Retirement Housing Managers, and RICS codes of practice on residential property management;
- with regard to the non-statutory codes, ARMA commenced its ARMA-Q scheme with effect from 1 January 2015. ARMA-Q is a self-regulatory regime designed to raise standards and quality of service across the residential leasehold management sector;
- ARMA's members were required to sign up to and be accredited to the new standards as a condition of continued membership;
- the Associated Retirement Community Operators (ARCO), the trade association for providers of housing-with-care developments for older people, introduced its Consumer Code in September 2015. All ARCO members have to commit to compliance with the Consumer Code.<sup>132</sup>

In response to the remedies requiring legislative change:

- MHCLG's response to the Consultation on Protecting Customers in the Letting and Managing Agent Market (April 2018) stated that it would introduce reforms to simplify

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<sup>131</sup> CMA, Implementation of the CMA's recommendations, 2016. Pages 3-5.

<sup>132</sup> CMA, Implementation of the CMA's recommendations, 2016. Pages 5-7.

the process of leaseholders exercising their Right to Manage. This work is currently being taken forward by the Law Commission who reviewing the Right to Manage legislation and have recently consulted and will report back to the department. The response document also stated that the Government would introduce measures whereby a leaseholder can veto a landlord's choice of managing agent where justified, periodically review their performance, and switch agents when agreed levels of service have not been achieved and maintained;

- In October 2018, the Government announced an independent Regulation of Property Agent working group, chaired by Lord Best and made up of experts across the property sectors, to provide advice to Government on establishing a new regulatory framework for property agents. The group also considered the use and transparency of service charges and other fees and charges as well as major works as part of its work. The working group published its final report in July 2019. The group recommended that Government should consider consulting on a revised major works consultation process.

In response to the suggested remedies for improving transparency and communication in blocks owned by local authorities and housing associations:

- MHCLG have worked with the Chartered Institute of Housing, National Housing Federation and the Local Government Association to employ a range of approaches in order to share best practice on improving communication with leaseholders in blocks owned by local authorities and housing associations;<sup>133</sup>
- The independent Regulation of Property working group also considered how fees such as service charges should be presented to consumers. The working group published its final report to Government in July 2019.

In response to suggested remedies for redress:

- Leaseholders can access free, impartial advice from LEASE. Moreover, LEASE is developing complaints guidance, clearly setting out the routes of redress available to leaseholders;
- The Government has announced, in its consultation response document on Strengthening Consumer Redress in the Housing Market, that it will be making all

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<sup>133</sup> CMA, Implementation of the CMA's recommendations, 2016. Page 6 .

freeholders of leasehold properties subject to statutory redress requirements, regardless of whether they employ a managing agent.<sup>134</sup>

### 6.3. Recommendations of Housing, Communities and Local Government Committee

The Housing, Communities and Local Government Committee launched an inquiry into the Government's leasehold reform programme and in particular looked at how existing leaseholders facing onerous leasehold terms in both houses and flats can be supported. In its report,<sup>135</sup> the Committee proposed a series of recommendations designed to balance the power between leaseholders - particularly in new build properties - and developers, freeholders and managing agents. A brief overview of these recommendations is included below.

The Committee proposed recommendations on the future of leasehold tenure:

- It recommends referring to leasehold tenure as 'lease-rental' to make it much clearer to prospective purchasers that this tenure is very different from freehold tenure;
- It recommends that the sale of houses under leasehold arrangements should cease, and that urgent action be taken to enable those leaseholders in houses to be given the right to enfranchisement under appropriate low cost arrangements;
- The Committee urges the Government to ensure that commonhold becomes the primary model of ownership of flats in England and Wales (except in complex, mixed-use developments and some retirement properties).

To address accusations of mis-selling, the Select Committee recommended that:

- The Government should require the use of a standardised key features document, to be provided at the start of the sales process by a developer or estate agent, and which should very clearly outline the tenure of a property, the length of any lease, the ground rent and any permission fees;
- The Government must close the legal loophole allowing developers to sell freeholds to subsidiary companies, by which means leaseholders lose out on the opportunity to

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<sup>134</sup>MHCLG, Strengthening Consumer Redress in the Housing Market, 2019.

<sup>135</sup> Housing, Communities and Local Government Committee, Leasehold Reform: Twelfth Report of Session 2017–19, 2019, London: House of Commons.

purchase the freehold at whatever price it is offered to the new freeholder. It concurred that the Government is right to seek to extend the right of first refusal to leasehold house owners;

- The standardised key features document should also include a price at which the developer is willing to sell the freehold within six months or, otherwise, a prescribed statement that the developer is not so willing, and that the purchaser would have to rely on their statutory rights;
- The Competition and Markets Authority should investigate mis-selling in the leasehold sector, and make recommendations for appropriate compensation;
- The Government should prohibit the offering of financial incentives to persuade a customer to use a particular solicitor;
- The Government should undertake a review to determine whether existing routes to redress, including the Legal Ombudsman's scheme, are satisfactory, or whether a new Alternative Dispute Resolution scheme should be established for leaseholders with legitimate claims against their solicitors.

Regarding onerous lease terms, the Committee recommended that:

- The Government should undertake a comprehensive study of existing ground rents to determine the scale of the problem of onerous ground rents and the level of compensation which would be consistent with human rights law;
- The Government revert to its original plan and require ground rents on newly established leases to be set at a peppercorn level (i.e. zero financial value);
- The Government should introduce legislation to restrict onerous permission fees in existing leases and in the leases of new-build properties;
- The Government should require that permission fees are only ever included in the deeds of freehold properties where they are reasonable and absolutely necessary;
- The CMA should exercise its powers under section 130A of the Enterprise Act 2002 to indicate its view as to whether onerous leasehold terms constitute 'unfair terms' and are, therefore, unenforceable.

The Committee's recommendations about service charges, one-off bills and dispute mechanisms are that:

- The Government should require the use of a standardised form for the invoicing of service charges, which clearly identifies the individual parts that make up the overall

charge. It should be clearly identified where commission has been paid to the managing agent or freeholder;

- The Government should immediately bring into force Sections 42A and 42B of the Landlord and Tenant Act 1987 to ensure that leaseholders' reserve funds are protected;
- There should always be a clear agreement between developers and local authorities before development begins as to the public areas and utilities that are to be adopted by local authorities. These details must be provided to prospective purchasers at the start of the sales process;
- The Government should implement a new consultation process for leaseholders affected by major works in privately-owned buildings. A threshold of £10,000 per leaseholder should be established, above which works should only proceed with the consent of a majority of leaseholders in the building;
- The Government should introduce a Code of Practice for local authorities and housing associations, outlining their responsibilities to leaseholders in social housing blocks and offering guidance on best practice for major works. Local authorities should be required to provide evidence to leaseholders that they are receiving the same value from procurement practices in the public sector as they might reasonably expect in the private sector. Furthermore, local authorities should be required to administer sinking funds for each of the buildings or estates that they are responsible for, so that leaseholders are less at risk of unexpected bills for major works;
- The Government must legislate to require that freeholders' tribunal costs can never be recovered through the service charge, or by any other means, where the leaseholder has won the case;
- The Government should immediately take up the Law Commission's 2005 proposals to reform forfeiture, to give leaseholders greater confidence in disputing large bills by reducing the threat of losing a substantial asset to the freeholder;
- The Government should seek to implement these measures with urgency, and to do so with a clear and joined-up approach that acknowledges how each of the measures might work together, in particular with a Specialist Housing Court and the Housing Ombudsman;
- The Government should review the case for mandatory regulation of the freehold sector, overseen by an Ombudsman, with redress and sanctions where appropriate;
- The Government should undertake a comprehensive review of the Leasehold Advisory Service (LEASE), with a focus on maximising the service provided to leaseholders.

The Government provided its response to the Select Committee report in July 2019.<sup>136</sup> The Government response included:

- bringing forward reforms to ensure that leasehold is only used for flatted developments in the future;
- banning the granting of new leases on houses other than in exceptional circumstances;
- ensuring that consumers only pay for the services they receive;
- ensuring that there is a greater choice of tenure for consumers and support for leaseholders who want to buy their freehold;
- ensuring that service charges and other charges are fair; ensuring information provided to homeowners or prospective buyers is transparent and communicated effectively; and
- ensuring that there is a clear route to challenge or redress if things go wrong.

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<sup>136</sup> MHCLG: Leasehold reform: government response to the Select Committee report, 2019.

## 7. Gaps in evidence

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Although the reviewed literature provides comprehensive information on the different charges that leaseholders and freeholders are required to pay, as well as on governing laws and relevant case law, there are gaps in existing evidence in the following areas:

- the calculation of service and administration charges, and sinking funds, for new and mixed-tenure developments, both in the private and social sectors;
- variations in these charges from year to year (e.g. the effect of building typologies on these charges, whether there are higher charges for new build properties, etc.);
- the circumstances in which service charges levied pursuant to the terms of a lease might be described as unreasonable, unreasonably incurred or unreasonable in standard or amount relative to the work that is done in consideration for the charge made;
- the nature of enforcement action that is taken if a charge is not paid;
- the scope and breadth of instances of doubling ground rent;
- trends in estate rentcharges (i.e. how common estate rentcharges are, and who the parties are within an estate rentcharge arrangement);
- whether and how an estate rentcharge can be challenged, and enforcement action if charges are not paid;
- developers' behaviour and rationale in setting these charges;
- the main themes of disputes between leaseholders and landlords;
- the impact of charges on the affordability of social housing;
- redress and enforcement of both landlords' and leaseholders' rights.