Reinvigorating commonhold: the alternative to leasehold ownership

Consultation Paper
Reinvigorating commonhold: the alternative to leasehold ownership
THE LAW COMMISSION – HOW WE CONSULT

About the Law Commission: The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law. The Law Commissioners are: The Rt Hon Lord Justice Green, Chairman, Professor Nicholas Hopkins, Stephen Lewis, Professor David Ormerod QC and Nicholas Paines QC. The Chief Executive is Phillip Golding.

Topic of this consultation: The law of commonhold. This Consultation Paper sets out options for reforming the law of commonhold and seeks consultees’ views as to those options. We also ask questions about the impact of our proposals and application in England and in Wales.

Geographical scope: This Consultation Paper applies to the law of England and Wales.

Availability of materials: The Consultation Paper is available on our website at https://www.lawcom.gov.uk/project/commonhold/.

Duration: We invite responses from 10 December 2018 to 10 March 2019.

Comments may be sent:

Using an online response form, which can be found at www.lawcom.gov.uk/project/commonhold/.
Where possible, it would be helpful if this form was used.

Alternatively, comments may be sent:
By email to propertyandtrust@lawcommission.gov.uk
By post to Commonhold Team, Law Commission, 1st Floor, Tower, 52 Queen Anne’s Gate, London, SW1H 9AG.
Tel: 020 3334 3100
(If you send your comments by post, it would be helpful if, whenever possible, you could also send them electronically.)

After the consultation: In light of the responses we receive, we will prepare our final recommendations for reform and present them to Government. In Chapter 16 of this Consultation Paper we ask questions which address wider issues surrounding the reinvigoration of commonhold, such as the need to raise consumer awareness, incentives and compulsion. These wider issues will be considered by Government, rather than by the Law Commission. Any responses which relate to these wider issues being considered by Government will be shared with Government.

Consultation Principles: The Law Commission follows the Consultation Principles set out by the Cabinet Office, which provide guidance on the type and scale of consultation, duration, timing, accessibility and transparency. The Principles are available on the Cabinet Office website at: https://www.gov.uk/government/publications/consultation-principles-guidance.

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Any queries about the contents of this Privacy Notice can be directed to: general.enquiries@lawcommission.gov.uk
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## Glossary and abbreviations

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<td>Commonhold Regulations</td>
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<td>Commonhold Amendment Regulations</td>
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<td>Commonhold (Land Registration) Rules</td>
<td>Commonhold (Land Registration) Rules 2004</td>
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<tr>
<td>Articles of association (“the Articles”)</td>
<td>The rules which govern how a company, including the <strong>commonhold association</strong>, operates, for example, how directors of the association are appointed.</td>
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<tr>
<td>Charge</td>
<td>A type of security interest. When a lender loans an amount of money, it will often seek a security interest over the borrower’s property, such as a charge or a mortgage. While charges and mortgages are technically different, in relation to land, most mortgages in fact take the form of a charge. When the borrower sells the property, lenders with the benefit of a charge will be repaid first out of the proceeds of sale, in priority to other lenders who do not have a charge. Property can be subject to multiple charges granted to different lenders.</td>
</tr>
<tr>
<td>Charging order</td>
<td>A charge imposed by the court on property. The court can impose a charging order if the owner of the property has been ordered in legal proceedings to pay a sum of money to another and has failed to do so. The person to whom the money should have been paid is said to have “the benefit of the charging order”. He or she may ask the court to order the sale of the property, in order to recover the money that is due to him or her.</td>
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<tr>
<td>Common parts</td>
<td>Any areas of the <strong>commonhold</strong> which do not form part of a <strong>unit</strong>. Common parts will generally include communal areas shared between unit owners (such as gardens and grounds, entrance halls, landings and staircases) and structural parts of the building, such as the external walls and the roof. Additionally, the common parts will include any pipes, cables and other installations, except for those situated within a unit and which serve only that unit.</td>
</tr>
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<td>Commonhold</td>
<td>A form of <strong>freehold</strong> property ownership created by the <strong>2002 Act</strong>. It enables individual properties within a building or larger development to be owned on a freehold basis. It provides a</td>
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structure to manage the relationship between these separate freehold properties (such as flats within a block of flats or houses on an estate) and to manage any common parts shared between them (the common parts).

**Commonhold association**
A private company limited by guarantee which owns the common parts and manages the commonhold.

**Commonhold community statement (“CCS”)**
The CCS is a document which sets out the rights and obligations of unit owners and the commonhold association. The CCS is also the document which defines the physical boundaries of the commonhold units (and therefore the common parts).

**Commonhold contributions**
The contribution to shared costs and the contribution to the reserve fund are referred to collectively as the commonhold contributions.

**Commonhold unit**
A separate, individually owned property (such as a flat) or area of land within a larger development. For instance, a unit may be a flat within a block of flats, or an office within an office block. A unit could also be an individual house on an estate with shared gardens, or an individual shop within a retail park. An area of land not connected to a building could also be a unit, such as a car parking space.

**Company limited by guarantee**
A type of private company, made up of members (in the case of a commonhold association, the members are the unit owners) and registered at Companies House. Its members do not hold shares in the company, but rather are liable to contribute towards the company's debts up to a certain limit. In the case of commonhold associations, this limit is £1. Unit owners are liable for this sum only in the event that the company becomes insolvent.

**Contribution to the reserve fund**
Sums that unit owners are required to pay into the commonhold’s reserve fund. The contribution is referred to in the 2002 Act as the “reserve fund levy”, but for clarity we have adopted the terms “contribution to the reserve fund” or “reserve fund contribution”. This contribution is separate from the contribution to shared costs.

**Contribution to shared costs**
Sums that unit owners are required to pay towards the day-to-day running costs of the commonhold, for instance paying for services provided and any ad hoc repairs required throughout the year. This contribution is referred to in the 2002 Act as the “commonhold assessment”, but for clarity we have adopted the terms “contribution to shared costs” or “shared cost contribution”. This contribution is separate from the contribution to the reserve fund.
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<td>Conveyancer</td>
<td>A lawyer (including a solicitor or licensed conveyancer) acting on the sale, purchase or mortgage of a <strong>freehold</strong> or <strong>leasehold</strong> property.</td>
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<td>Equity (in a unit)</td>
<td>A unit owner’s “equity” in his or her unit is the “net value” of the unit to him or to her. The net value is the market value of the unit minus the value of any charges secured on the property, including those secured by charging orders.</td>
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<tr>
<td>Flying freehold</td>
<td>A <strong>freehold</strong> property which in part or in whole does not touch the ground, and consequently is situated above another freehold, or leasehold. For instance, a first-floor flat is situated above the ground-floor flat, and so would be a flying freehold if sold on a freehold rather than leasehold basis.</td>
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<td>Freehold management company (“FMC”)</td>
<td>A FMC is a <strong>residents’ management company</strong> which also owns the <strong>freehold</strong> of a block of flats (or other development). The FMC will therefore be the <strong>landlord</strong> of the <strong>leaseholders</strong> in that block or development.</td>
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<tr>
<td>Freehold</td>
<td>A form of property ownership that lasts forever, and which generally gives fairly extensive control of the property.</td>
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<td>Freeholder</td>
<td>The owner of the <strong>freehold</strong> interest in the property. The freeholder has a superior interest to any person with a <strong>leasehold</strong> interest in the same property.</td>
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<td>Insolvent</td>
<td>A company, including a <strong>commonhold association</strong>, is said to be insolvent if it has insufficient assets (such as money or other property) with which to meet its debts and financial liabilities.</td>
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<td>Landlord</td>
<td>A person (either an individual or a company) who grants a <strong>leasehold</strong> interest out of his or her property interest. A landlord may be the <strong>freeholder</strong> of the property, in which case, the leasehold interest will be granted directly out of the freehold interest. Alternatively, a landlord may be a leaseholder, in which case the landlord will grant a sub-lease out of his or her leasehold interest.</td>
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<td>Leasehold</td>
<td>A form of property ownership which is time-limited (for example, ownership of a 99-year lease), where control of the property is shared with, and limited by, the <strong>landlord</strong>.</td>
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<td>Leaseholder</td>
<td>A person who holds a <strong>leasehold</strong> interest in a property, granted by a <strong>landlord</strong>.</td>
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<td>Leaseholder-controlled company</td>
<td>A collective term which includes residents’ management companies, freehold management companies and right to manage Companies.</td>
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<td>Term</td>
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<td>Limited use area</td>
<td>An area within the common parts which has been designated for the exclusive use of one or more unit owners. Limited use areas will be specified in the CCS.</td>
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<td>Local rule</td>
<td>A provision in the CCS which is specific to that particular commonhold, rather than one which is required by law to apply to all commonholds.</td>
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<td>Long lease</td>
<td>A lease that is granted for a term of more than 21 years.</td>
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<td>Negative equity</td>
<td>A unit owner (or a unit) will be in negative equity when the total value of the charges which are secured on the property exceed its market value. See also equity, above.</td>
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<td>Off-plan</td>
<td>A sale “off-plan” occurs when the unit has not yet been constructed, and so the contract for sale is based on a reference to a plan, written description and specification.</td>
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| Ordinary resolution                      | A collective decision of the commonhold association’s members, where: \[\text{if the decision is made in a meeting, over 50\% of the votes cast by those present and voting are in favour of the decision; or}
|                                          | \[\text{if the decision is made by the written procedure, over 50\% of all the votes in the commonhold are cast in favour.}\] Compare with a special resolution and unanimous resolution.                                  |
| Premium                                  | A lump sum payable to the freeholder in addition to any sums due under the lease. A premium will be payable to purchase the leasehold interest, to obtain a lease extension and to acquire the freehold of the property.             |
| Positive covenant                        | An obligation that requires a property owner to do something, such as carry out repairs or spend money for the benefit of another property.                                                                |
| Reserve fund                             | A pool of money which is set aside to cover the costs of future, one-off or major works needed in the commonhold, such as replacement of the lift or roof.                                                                 |
| Residents’ management company (“RMC”)   | An RMC is a company which is owned and controlled by the leaseholders in a block of flats or other development. The RMC is responsible for the repair and maintenance of the structure and common parts of the development (as defined in the particular lease). |
| Resolution                               | A collective decision of the commonhold association’s members.                                                                                                                                             |
Right to manage company ("RTMCo")
A RTMCo is a specific type of residents’ management company, set up by the leaseholders exercising their statutory right to manage in the 2002 Act.

Service charge
A charge payable by the leaseholders under the terms of the lease to cover the cost of services provided by the landlord or a management company. Typically, these include matters such as the repair and maintenance of the common parts, the insurance of the buildings and the upkeep of any garden and parking areas.

Shared ownership lease
A lease under which the leaseholder purchases an equity “share” of a house or flat (usually between 25% and 75%) and pays rent on the remainder of the property. The lease permits the leaseholder to acquire additional shares in the property over time, usually up to 100%.

Special resolution
A collective decision of the commonhold association’s members, where:

- if the decision is made in a meeting, at least 75% of the votes cast by those present and voting are in favour of the decision; or
- if the decision is made by the written procedure, at least 75% of all the votes in the commonhold are cast in favour.

Compare with an ordinary resolution and unanimous resolution.

Transitional period
If land is registered as commonhold land at a time when the identities of the individual unit owners are not yet known (for instance, when a new commonhold development is being built and the prospective purchasers are not yet known), a transitional period begins. During this period, the CCS is not in force, and the commonhold association does not own the common parts. The freeholder of the commonhold land (usually the developer) will remain the owner of all the units and the common parts. Once one or more (but not all) of the units have been sold to another person, the transitional period comes to an end.

Tribunal
The First-tier Tribunal (Property Chamber) in England and the Residential Property Tribunal in Wales. Each has jurisdiction over a number of aspects of residential leasehold law, and housing law more generally.

Unanimous resolution
A collective decision of the commonhold association’s members, where:

- if the decision is made in a meeting, 100% of the votes cast by those present and voting are in favour of the decision; or
- if the decision is made by the **written procedure**, 100% of all the votes in the commonhold are cast in favour.

See also **ordinary resolution** and **special resolution**.

| **Unit owner** | The **freehold** owner of a particular commonhold **unit**. Unit owners are referred to in the 2002 Act as “unit holders”, but for clarity we adopt the term “unit owner”. |
| **Unit** | See **commonhold unit** above. |
| **Written procedure** | The written procedure can be used to pass a **resolution** of the **commonhold association** without requiring a meeting of the members. The procedure requires the members to sign a document containing the wording of the **resolution**. |
Part I: Introduction
Chapter 1: Introduction

BACKGROUND

1.1 Commonhold was introduced in 2002 as a new way to own freehold 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.

1.2 Currently, flats are almost universally sold on a leasehold basis, as difficulties arise where flats are sold as freehold. Commonhold provides a structure which enables the freehold ownership of flats and, as such, offers an alternative to residential leasehold.

1.3 Whilst primarily designed to enable the freehold ownership of flats, commonhold is equally capable of applying in a commercial context. It can, for example, regulate the relationship between individually owned offices within an office block.

1.4 Commonhold offers a number of advantages over leasehold ownership. In particular, it allows a person to own a flat forever, with a freehold title – unlike a leasehold interest, which will expire at some point in the future. It also gives the commonhold owners greater control of their property than leasehold. However, despite these apparent advantages, fewer than 20 commonholds have been created since the commonhold legislation came into force.¹

1.5 Various suggestions have been made as to why commonhold has not taken off. Some have suggested that shortcomings in the law governing commonhold have led to a lack of confidence in commonhold as a form of ownership. Some ascribe commonhold’s failure to an unwillingness of mortgage lenders to lend on commonhold units. Some think that there may be a lack of consumer and sector-wide awareness of what is a relatively unfamiliar form of ownership. Others point out that commonhold remains less attractive to developers than leasehold because of the opportunities that leasehold offers to secure ongoing income-streams on top of the initial purchase price paid by the leaseholders. And others suggest that the low uptake is more the result of inertia among professionals and developers. Moreover, we have been told that there is insufficient incentive (financial or otherwise) for those involved in building homes and commercial property to change their practices and adopt a whole new system while the existing one (from their perspective at least) does the job.

SCOPE OF OUR PROJECT

1.6 Our commonhold project seeks to address the first suggested barrier to the uptake of commonhold in paragraph 1.5 above: perceived shortcomings in the legal design of the commonhold scheme. Our project attempts to find out which aspects of the law of commonhold have so far impeded commonhold’s success and, in accordance with our Terms of Reference with Government, to “propose reforms to reinvigorate commonhold

¹ Commonhold was introduced into law by the Commonhold and Leasehold Reform Act 2002 (“the 2002 Act”, or in footnotes “CLRA 2002”) the main provisions of which came into force on 27 September 2004.
as a workable alternative to leasehold, for both existing and new homes”. Our full Terms of Reference are set out in Appendix 1.

1.7 Other barriers to the uptake of commonhold, including those identified in paragraph 1.5 above, are not problems with the law and do not fall within our Terms of Reference. They are issues which Government is considering, and our project has provided an opportunity to gather evidence on these wider measures to reinvigorate commonhold. We will share the evidence we receive with Government. Separately, Government has already proposed measures which will have the effect of reducing some of the financial incentives for developers to prefer leasehold over commonhold. ²

1.8 Our commonhold project is part of a wider project on residential leasehold and commonhold reform which was included in our Thirteenth Programme of Law Reform, published in December 2017.³ The Ministry of Housing, Communities and Local Government (“MHCLG”) supported the project as required by our statutory Protocol with Government.⁴ The project is also supported by the Welsh Government in so far as it relates to devolved matters.⁵

1.9 Our wider project is made up of three strands: the right to manage, leasehold enfranchisement and commonhold. The right to manage enables leaseholders to take over the management of their building, without buying the freehold. Enfranchisement provides leaseholders of houses with a statutory right to buy their freehold or obtain a lease extension. Enfranchisement also provides leaseholders of flats with a statutory right to obtain a lease extension and (together with other leaseholders) a collective right to buy the freehold (known as “collective enfranchisement”). A leaseholder may decide to seek a lease extension if the term of his or her lease has reduced to a length which makes the flat difficult to sell. Leaseholders may decide to exercise the right of collective enfranchisement if they want to take over the management of their building and own the freehold.

1.10 Two strands of our wider project will therefore focus on reforms to leasehold law, to make it easier, quicker and more cost-effective to exercise leasehold rights. Our commonhold project is different. Commonhold is designed to create a new system of ownership which offers an alternative to leasehold. In this chapter, we explain what commonhold is, why it was introduced and what advantages it can offer over leasehold ownership. Next, we explore the key difficulties with the current law of commonhold and provide a brief overview of our provisional suggestions for reform. We then put our project into context, explaining how our approach to reform has been shaped by wider developments. We then consider some overarching policy considerations that have

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² The Ministry of Housing Communities and Local Government (“MHCLG”) has proposed capping ground rents in new leases to £10 per annum: MHCLG, Implementing reforms to the leasehold system in England: A consultation (2018), para 3.15.
⁵ On which see further at para 1.85 below.
informed our consideration of commonhold. Finally, we discuss the impact of our commonhold project and set out the structure of this Consultation Paper.

WHAT IS COMMONHOLD?

1.11 Commonhold has a long legislative history in England and Wales. It was first proposed in 1987 by a working group headed by Law Commissioner, Trevor Aldridge. The report was prepared independently of the Law Commission following consultation with a select group of interested bodies. A succession of consultations and draft Bills followed the so-called “Aldridge Report” before commonhold was introduced into law by the Commonhold and Leasehold Reform Act 2002 (“2002 Act”).

1.12 The working group chose the name “commonhold” as it seemed to convey “both the notion of land ownership and the “element of community of interests and co-operation in management” intrinsic to the scheme.

1.13 As explained above, commonhold facilitates the freehold ownership of flats as an alternative to leasehold ownership. There are fundamental differences between freehold and leasehold ownership.

Freehold and leasehold ownership

1.14 In England and Wales, property may be owned on a freehold or a leasehold basis. Freehold is ownership that lasts forever, and generally gives fairly extensive control of the property. In contrast, leasehold provides time-limited ownership (for example, a 99-year lease) and control of the property is shared with, and limited by, the freehold owner (that is, the landlord).

1.15 So, whilst we refer to “buying” or “owning” a house or a flat on a leasehold basis, we are in fact buying that property for a certain number of years, after which time the property goes back to the landlord. A leasehold interest is therefore often referred to as a “wasting asset”: its value tends to reduce over time as its length reduces and becomes unmortgageable towards the end of its term. It may therefore be necessary to pay the landlord to extend the lease. While legislation gives leaseholders a statutory right to extend a lease through enfranchisement, it can be expensive to do so.

1.16 In addition, leasehold owners often do not have the same control over their homes as freehold owners. For example, they may not be able to make alterations to their homes, or even choose which type of flooring to have, without obtaining the permission of their landlord. The balance of power between leasehold owners and their landlord is governed by the terms of the lease and by legislation. A landlord may have different interests from the leaseholders. For instance, the landlord may see leasehold solely as an investment opportunity or a way of generating income, while for leaseholders the property may be their home, as well as a capital investment.


7 Aldridge Report, preface, para 3.
In summary, therefore, leasehold does not provide outright ownership. The experience of leasehold owners has been summed up as being that of “owners yet tenants”. On the one hand, leaseholders are homeowners, with some of the benefits that ownership brings (such as a financial stake in the home). On the other hand, they have a landlord who maintains some control over their use of their home, and who will ultimately take back the home if the lease expires.

Many purchasers do not understand what leasehold ownership involves. Further, even when they do, there is often no choice over the form of ownership. Flats are almost always sold on a leasehold basis, for reasons we now discuss.

Why flats are sold on a leasehold basis

Flats are sold on a leasehold basis for practical reasons, to avoid the difficulties which otherwise arise where flats are sold as freehold. Whilst it is possible for flats to be sold on a freehold basis outside the commonhold structure (known as “flying freeholds”), freehold ownership of flats creates a number of problems. In particular, “positive obligations” to pay money or perform an action in relation to a property (such as to repair a wall or a roof, or to pay towards the costs of repair) cannot legally be passed to future owners of freehold property.

Positive obligations are especially important for the effective management of blocks of flats, given that flats are structurally interdependent. The failure of certain owners to repair their flats, for example, could cause significant damage to other owners’ properties or their value. However, once a freehold flat has been resold, the subsequent owners will generally not be under an obligation to repair their property. Flats are therefore sold on a leasehold basis which allows repairing (as well as other) positive obligations to be transferred to future owners.

In most other countries, flats can be owned as freehold. Structures have been put in place to enable the freehold ownership of flats, for instance, “strata title” in Australia and “condominium” in America. Commonhold offers a similar structure to strata title and condominium for England and Wales.

The commonhold structure

Commonhold provides a structure to manage the relationship between separate, individually owned properties. Under the commonhold structure, the freehold of an individual property, referred to as a “unit” (such as a flat), is owned by a “unit owner”. The unit forms part of a building or development. For example, a unit may be a flat within a block of flats or an office within an office block. A house on an estate with

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9 We discuss flying freeholds in more detail in ch 5.
10 The Law Commission has previously recommended the creation of a new interest in land (“the land obligation”) which can be positive or negative and will bind future owners of the land. However, the needs of freehold flats and other multi-occupancy developments would not be met satisfactorily by this new land obligation: Making Land Work (2011) Law Com No 327 paras 1.10, 5.17, 5.18, 5.90 and 5.91.
11 Another practical difficulty is that mortgage lenders can be reluctant to lend against the security of a freehold flat.
shared gardens could be a unit, as could an individual shop within a retail park. It is also possible for an area of land not connected to a building to be a unit, such as an allocated car parking space.

1.23 Anyone who buys a unit in a commonhold will become a member of a company which owns and manages the common parts of the building or development (such as communal areas shared between the unit owners). This company is called the “commonhold association”. Unit owners, as members of the commonhold association, can vote on decisions which affect the commonhold.

1.24 The commonhold association must have at least two directors who carry out the management functions of the commonhold. These directors can either be unit owners themselves or external professionals.

1.25 Each commonhold has a “commonhold community statement” (‘CCS’). This document defines the physical boundaries of the commonhold units and sets out the rights and obligations of the unit owners and the commonhold association. For example, the CCS sets out unit owners’ voting rights and their requirement to contribute towards the costs of the commonhold (referred to as “commonhold contributions”).

1.26 Additionally, each commonhold must adopt “articles of association” – the legal name given to the rules that govern a company. In the commonhold context, these are the rules which govern how the commonhold association operates and how management decisions about the commonhold can be made. For example, the articles of association set out how directors are appointed and what their duties are, how meetings of members are called, and how unit owners’ votes are cast.

1.27 There are certain terms (referred to as “prescribed terms”) which must be included in every CCS and articles of association. These terms create a level of consistency across all commonholds.

**Commonhold’s advantages over leasehold**

1.28 The commonhold structure is presented as having a number of advantages over leasehold ownership. The main advantages of commonhold are set out below.

(1) **Freehold ownership**: commonhold enables units to be owned forever and therefore removes the disadvantage of having a lease as a wasting asset and the need for lease extensions.

(2) **Self-management by the flat owners**: commonhold gives ownership and control of the block to the unit owners. Where flats are owned as leasehold, the management of the block of flats is often controlled by a landlord. The landlord may have different interests from the leaseholders, which can foster an attitude of “them and us”. For instance, the landlord may see leasehold as an investment opportunity or a way of generating income, such as through charging ground rent or obtaining insurance commissions. In a commonhold, however, the block is managed by a company made up of the unit owners. The interests of the unit owners and the company which manages the commonhold should therefore be the same, which provides a better starting point for living in and managing a residential development. That alignment of interests should also have various
practical benefits, such as reducing the potential for disputes, and facilitating the installation of energy efficiency measures in a building, as the same people who benefit from the upgrades will be those who are paying for them.\textsuperscript{12}

(3) \textit{Standardisation:} commonholds have standard rules and regulations which should make conveyancing simpler and cheaper. It should also be easier for homeowners to understand their rights and obligations. The main rights and obligations will be contained in the prescribed CCS and will apply to all commonholds. Additionally, the CCS must be provided to owners in a certain format, making it easier for prospective purchasers and their advisors to identify any terms that are unusual or would be of concern to the particular purchaser.\textsuperscript{13} The rules which apply to each owner in a building will, for the most part, be the same and set out in the same document (with some scope for different voting rights and commonhold contributions). By contrast, in a block of flats, the individual flat leases may contain terms which are inconsistent with each other.

(4) \textit{Flexibility to accommodate change:} given that some of the terms of the CCS and articles of association are prescribed by law, Government can respond relatively easily to changing needs by amending these terms. For example, Government could introduce terms to facilitate greater consumer protection in commonhold, improve fire safety measures (or other health and safety measures) and encourage “green” energy initiatives. It is also easier for unit owners to amend the rules of the commonhold that are not prescribed by Government. Currently, unit owners can agree to vary certain rules about how their building is run with anything over 50% support. In contrast, varying the terms of all leases in a building is extremely difficult. Generally, even minor variations need the support of at least 75% of the leaseholders in the building, require an application to the First-tier Tribunal (Property Chamber) or Residential Property Tribunal Wales (“the Tribunal”), and can be blocked if 10% of the leaseholders oppose the variation.\textsuperscript{14} However, as we discuss later in this chapter, we put forward provisional proposals to make it harder to vary certain commonhold terms so that the benefit of flexibility can be retained whilst unit owners enjoy greater certainty and protection.

\textsuperscript{12} In leasehold, by contrast, proposals for energy efficiency measures create practical difficulties since (a) energy efficiency measures will generally be improvements and leases often only allow the costs of repairs and maintenance to be recovered through the service charge, and (b) landlords do not have any incentive to pay the installation costs since it is leaseholders (and not landlords) who gain the benefits of energy efficient measures from reduced energy bills.

\textsuperscript{13} For example, a term preventing pets that will be of concern to purchasers who wish to keep pets.

\textsuperscript{14} An application can be made to vary one or more leases at the same time but only if the purpose of the variation can be achieved if all the leases are varied. Where fewer than 9 leases are sought to be varied, all – or all but one – of the leaseholders must agree to the variation. Where 9 or more leases are sought to be varied, 75% of the leaseholders must support the decision and the decision must not be opposed by more than 10% of the leaseholders. It is also possible for leases to be varied where the terms of the lease do not make satisfactory provision for matters such as management or recovery of costs. For example, if the leaseholders collectively have to pay 90% or 110% of the costs of managing the building and the rest is either a shortfall or a profit, a leaseholder may apply to the First-tier Tribunal for their individual lease to be varied. An application may then be made for other leases in the building to be varied in the same way: Landlord and Tenant Act 1987, ss 35 to 37.
(5) *No risk of forfeiture.*\(^{15}\) where a leaseholder breaches the terms of the lease, forfeiture enables the landlord to bring the lease to an end and take back the property. The landlord is not required to pay any money to the leaseholder even when the property is worth more than the debt owed. The Law Commission has previously recommended abolishing forfeiture and replacing it with a new statutory scheme to respond proportionately to breaches of obligations by leaseholders.\(^{16}\) But Government has not indicated whether it will take forward reform and so forfeiture remains a risk for leaseholders and their lenders.\(^{17}\) There is no forfeiture within commonhold.

**Commonhold’s advantages over collective enfranchisement**

1.29 As explained in paragraph 1.9 above, collective enfranchisement enables leaseholders to take over the management of the building and acquire the freehold. Some stakeholders have asked us what differences there are between collective enfranchisement and commonhold and what additional benefits commonhold can offer.

1.30 The main difference between commonhold and collective enfranchisement is that, in commonhold, all homeowners have the same type of interest. They will each own the freehold of their flats and will not have a landlord. The same individuals will be members of the company which owns and manages the common parts of the building.

1.31 Following a collective enfranchisement, on the other hand, leaseholders will not acquire the freehold of their flats. They will continue to occupy their flats under the terms of a lease. The leaseholders that contributed towards the cost of buying the freehold will each obtain a "share of freehold". The way in which the freehold is shared between the leaseholders can take many forms. Often the leaseholders will set up a company to own the freehold, and the leaseholders will be members of the company. This company would then be the landlord of all leaseholders in the building. The company could grant those leaseholders who had financed the purchase longer leases of their flats at a nominal ground rent without requiring a premium. Other leaseholders, who did not participate in the enfranchisement or contribute towards the purchase price, will usually remain on their existing leases,\(^{18}\) and will pay any ground rent or premiums for a lease extension to the company. These sums would then be shared amongst those who had financed the purchase.

1.32 Therefore, whilst following a collective enfranchisement the building will be controlled by leaseholders, the two opposing interests (landlord and leaseholder) continue to exist. Usually, there will be also two tiers of interest: those who have participated and bought

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\(^{15}\) Several respondents to our Call for Evidence cited the lack of forfeiture as an advantage of commonhold over leasehold.


\(^{17}\) See ch 14 for further discussion on the impact of forfeiture on mortgage lenders.

\(^{18}\) Unless and until they exercise their statutory right to a lease extension or agree with the participant leaseholders to buy a share of the freehold.
a share of the freehold, and those who have not. Those that have participated in the freehold purchase will “wear two hats” as leaseholders and as owners of a share in the freehold. Those with a share of the freehold will usually manage the common parts of the building, but in doing so will be subject to the terms of all the leases in the building. The terms of the individual leases will dictate how the property is managed. As explained above, lease terms can be difficult to vary.

1.33 Whilst collective enfranchisement provides leaseholders with the opportunity to self-manage, it does not provide the advantages of commonhold that we identify below. For this reason, collective enfranchisement has been described to us as “commonhold lite”. The benefits of commonhold over collective enfranchisement stem from the fact that commonhold has been specifically designed for managing a building collectively without an external landlord. The commonhold legislation therefore contains bespoke provisions which cover every aspect of management. The advantages of commonhold, over collective enfranchisement, include the following.

(1) Unit owners have freehold tenure, so there is never any further need to consider extending leases.

(2) The standardisation inherent in commonhold should result in savings (this is explained further at paragraph 1.28(3)). Leases within a collective enfranchisement will continue to have been individually drafted for the development.

(3) As all rights and obligations in commonhold are contained in a single document, any inconsistency would be immediately apparent. With a collective enfranchisement leases may be inconsistent with one another.

(4) Unit owners in commonhold can respond to changing circumstances by amending the CCS.21 Leaseholders would have to go to the considerable trouble and expense of making an application to the Tribunal to vary all the leases.

(5) When there is a pressing need to provide generally for some matter of widespread concern to homeowners, Government can respond by updating the CCS of all commonholds by regulation.22 Government might, for example, do this to make provision for energy-saving measures, or to improve fire safety.

(6) There is no risk of forfeiture in commonhold (as explained further at 1.28(5)). We make provisional proposals to ensure that commonhold associations are given an effective means of ensuring that contributions to shared costs are paid.23 These proposals include the possibility that ultimately a unit may be sold under the supervision of the court. In such a case, however, once arrears of

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19 In fact, after collective enfranchisement, it is possible for re-enfranchisement to take place. Re-enfranchisement creates a “ping-pong” effect whereby a certain group of leaseholders acquire the freehold, only to be bought out by a different group of leaseholders.

20 See para 1.28(4).

21 See ch 8.

22 See ch 8, paras 8.49 to 8.50.

23 See ch 14.
contributions were cleared, a unit owner would receive the full value of his or her stake in the unit.

(7) Expenses relating to the administration of the commonhold association can automatically be included in the contributions to shared costs. These include items such as accountancy fees, fees payable to Companies House and any costs incurred in holding meetings of the members and directors. Companies which own the freehold, following a collective enfranchisement, may have difficulty in recovering these expenses.

(8) If they follow the prescribed procedures, the directors of a commonhold association will always be able to recover expenditure incurred in managing and maintaining the commonhold. In a collective enfranchisement, there is a risk that payments will not be recoverable.24

(9) The procedures which apply in commonhold in relation to consultation on commonhold contributions, and approval of the level of the contributions, have been designed specifically with commonhold in mind. The procedures assume that there is an identity of interests between the directors of the commonhold association and the unit owners.25 The consultation procedures which apply within a collective enfranchisement presuppose that there is an external landlord, and are based on an “us and them” starting-point.

(10) The mechanisms for resolution of disputes within commonhold reflect the reality that there is a community of unit owners.26 Mechanisms for the resolution of disputes between the company and the leaseholders within a collective enfranchisement are still largely based on the assumption that a landlord needs to attempt to enforce the terms of the lease against the leaseholder.

(11) Membership of the commonhold association is mandatory for all unit owners.27 A company running a block following collective enfranchisement often has to resort to various devices to attempt to ensure that new leaseholders become members (and that those who no longer own a lease do not continue to be members).

(12) Our provisional proposals make it easier for commonholds to raise funds to carry out emergency repairs through granting charges over the common parts or the income of the commonhold association.28 It is rarely possible for an enfranchised leasehold company to borrow on the security of its freehold reversion.

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24 Payments may not be recoverable, for example, if the directors do not correctly follow the consultation procedure prescribed by Landlord and Tenant Act 1985, s 20, or if they have incurred expenditure which is subsequently held not to have been reasonably incurred under Landlord and Tenant Act 1985, s 19.

25 See ch 10.

26 See ch 13.

27 See ch 7, para 7.7.

28 See ch 11. As we explain in this chapter, it is likely to be more convenient both for borrower and lender for any fixed charge to be granted over part of the common parts.
Commonhold offers a fairer and more orderly way of dealing with the redevelopment of a commonhold when the building itself has reached the end of its useful life. Leasehold makes poor provision for how a block of flats should be redeveloped when it is no longer capable of being updated.

The starting point of commonhold is that it is intended to be a democratic, co-operative community in which unit owners actively participate, and take responsibility for their commonhold. Its structures are intended to foster participation. The structures, if not the aspirations, within collective enfranchisement perpetuate an adversarial approach which has become identified with leasehold generally.

Underpinning these individual examples is the fact that commonhold is predicated on a different way of thinking about ownership of flats than is leasehold. Leasehold is based on the fact that every flat or unit is owned by two parties – the landlord and the tenant – who have different rights over the same property and whose interests may not be aligned. This starting point, and the culture it creates, may still exist where the leaseholders have collectively enfranchised. Commonhold, in contrast, takes as its starting point that each unit is owned by one party – the unit owner. The unit owners collectively own and manage the common parts by virtue of their ownership of the units. The interests of the unit owners and of the commonhold association are therefore inherently aligned.

Not everyone sees the absence of an external landlord as an advantage. We have heard concerns that people are not capable of, nor interested in, managing their block. Those arguments are understandable when commonhold is looked at through the lens of landlord and leaseholder. But commonhold requires a change in thinking. Commonhold is designed to empower homeowners to take responsibility. Freehold owners of houses who have invested significant sums in their homes must take responsibility for their homes. We think that freeholders of a flat can be expected to do the same. Of course, unit owners may choose to appoint professional directors and managing agents. In larger and more complex developments the appointment of professionals may be usual. But those appointed will be working directly for those who own the units.

Commonhold therefore has a range of advantages over leasehold. Yet we have also heard about a number of problems in the law of commonhold which need to be addressed for commonhold to succeed.

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29 See ch 15.
PROBLEMS WITH THE LAW OF COMMONHOLD – AND HOW THEY MIGHT BE ADDRESSED

Our Call for Evidence

1.37 In July 2016, we launched a public consultation asking which areas of law should be included within our Thirteenth Programme of Law Reform. In response, a number of consultees suggested that we review the law of commonhold, highlighting various problems with the existing commonhold model. Those responses provided the basis for our current project.

1.38 The first stage of our commonhold project was a Call for Evidence which we published in February 2018. The Call for Evidence set out the problems with the law of commonhold that we had been told about and which we had uncovered in our initial research. We asked whether these issues created a problem in practice and whether there were any other problems that we had not identified. We also asked about wider issues which might create a barrier to commonhold’s success, and have passed consultees’ views on these matters to Government.

1.39 We received 143 responses to the Call for Evidence from a wide variety of stakeholders. Consultees shared their invaluable experience of how the issues raised would create a difficulty for them in practice. The responses also brought to light a number of additional concerns which will need to be addressed in order to make commonhold workable.

1.40 Alongside our Call for Evidence, we invited the 150 existing commonhold unit owners and those managing commonholds to complete a survey in order to share their personal experience of commonhold. We received 31 responses to our commonhold survey, representing 20% of those we contacted. In response to the survey, the majority said that they enjoyed living in a commonhold, but made certain suggestions as to how the commonhold model could be improved.

1.41 We summarise the responses that we received to our Call for Evidence and our commonhold survey in an Analysis of Responses which we have published alongside this Consultation Paper.

1.42 The legal issues raised in response to our Call for Evidence fall within three broad categories:

   (1) issues in the process of creating or converting an existing building to commonhold;

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30 Every three to four years, we launch a wide public consultation, asking for appropriate projects to include within our next programme of law reform.

31 In our Thirteenth Programme of Law Reform, we identified residential leasehold law as an area which might benefit from reform and sought views on the problems being faced in practice. We received over 150 responses, from a range of stakeholders, which supported a review of one or more aspects of residential leasehold law. Five of these responses (including a joint response from several members of the First-tier Tribunal (Property Chamber) and academics), proposed a review of commonhold so that it could provide a workable alternative to leasehold.


33 See Commonhold: A Call for Evidence – Analysis of Responses, para 13.20.
2. issues which may make commonhold unattractive to homeowners; and

3. issues which may make commonhold unattractive across the wider property sector.

1.43 We summarise those issues below, and some of our provisional proposals which are intended to address them. Comments from respondents on a fourth category of wider measures to reinvigorate commonhold are set out in our Analysis of Responses, and we have passed them to Government.

Issues in the process of creating or converting to commonhold

1.44 Stakeholders responding to our Call for Evidence highlighted the difficulty converting from leasehold to commonhold. Under the current law, to convert an existing building to commonhold it is necessary to obtain the consent of everyone with a significant interest in the property, including the freeholder and all long leaseholders. In practice, this is almost impossible to achieve. Our Terms of Reference require us to make recommendations that would enable commonhold to become a viable alternative to leasehold, not only for prospective homeowners, but also for existing leasehold homeowners. Under the current law, most existing leaseholders will not be able to benefit from commonhold due to the difficulty of converting. Therefore, in Chapter 3 we consider how the consent requirement could be made easier to satisfy. We explore how a building might be converted to commonhold without the freeholder’s consent and set out options for reducing the threshold of leaseholder support required to convert.

Issues which may make commonhold unattractive to homeowners

1.45 Stakeholders highlighted a number of legal issues that impact on how well commonhold works for homeowners, particularly in relation to commonhold costs. Stakeholders referred to a lack of flexibility in how commonhold costs are shared, a lack of control over how these costs are set, and insufficient recourse against those who fail to pay their share.

1.46 While currently it is possible to require different units to contribute different percentages towards commonhold costs, an individual unit owner must contribute the same percentage towards every single cost. To provide greater flexibility in how costs may be shared, in Chapter 10 we provisionally propose that it should be possible to create separate “heads” or “pools” of cost. Additionally, to provide owners with greater control over commonhold costs, we suggest providing commonhold unit owners with a right to vote on the commonhold budget set by directors. In Chapter 14 we provisionally propose reforms to improve the enforcement powers of the commonhold association against unit owners who do not pay their share of the costs. This proposal will reduce the risk that other owners will be required to meet the shortfall.

1.47 Stakeholders have also advised us of the importance of an effective dispute resolution procedure in commonhold. We are mindful of the social dynamic of commonhold, which will often involve people living in close proximity, and we are aware of the importance of preventing disputes from escalating. In Chapter 13 we set out proposals to make the

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34 A long lease is a lease that is granted for a term of more than 21 years.

35 The budget will dictate the total amount which has to be raised from the unit owners in the following year.
dispute resolution procedure more effective. However, regardless of the form of property ownership, tensions can and will arise. Commonhold cannot of itself completely prevent disputes from arising.

1.48 Additionally, as previously alluded to, we have responded to concerns that commonhold does not offer unit owners sufficient certainty. Whilst an often-cited advantage of commonhold over leasehold is the flexibility to amend the rules of the commonhold, we are concerned that too much flexibility could lead to a lack of certainty and protection for unit owners. We therefore present ways of making certain rules harder to amend and consider ways of protecting the minority in Chapters 8 and 13. We also consider, in Chapter 15, whether the procedure for terminating the commonhold sufficiently protects those who do not want the commonhold to end.

Issues which may make commonhold unattractive across the wider property sector

1.49 We received responses from a wide range of stakeholders across the property sector in response to our Call for Evidence, including developers, mortgage lenders, conveyancers and housing associations.

1.50 Broadly, developers argued that commonhold was not currently sufficiently flexible to cater for larger developments, which combine both residential and non-residential elements, such as shops and leisure facilities. There was a concern, for example, that commercial owners could be outvoted by residential owners, and vice versa.

1.51 Whilst some stakeholders have suggested that our project should focus on purely residential developments, we want commonhold to have as wide an application as possible and benefit as many leaseholders as possible. The number of mixed-use developments has increased significantly since commonhold was first proposed in 1987. We want to facilitate the creation of commonhold “communities” which can accommodate not only living spaces but also facilities such as shops, restaurants and leisure facilities for those who live there. We also want commonhold to be able to accommodate different tenure types within the same development, such as affordable housing. We think that for commonhold to be a viable alternative to leasehold it must be able to accommodate these types of development.

1.52 In response to developers’ concerns, in Chapter 5 we provisionally propose the introduction of “sections”, based on company law principles of class-voting, which would allow different interests within the same commonhold to be separated out.

1.53 In Chapter 6 we also look at how developers might be able to continue developing once some, but not all, of the units on the development have been sold. We set out provisional proposals for a new way of developing commonholds in phases. However, we note that the need for developer flexibility should be balanced against the certainty and protection that must be provided to unit owners who buy before the development is complete.

1.54 Developers and housing associations also referred to the inability to incorporate shared ownership leases within commonhold. Shared ownership leases are long leases used to deliver Government-backed affordable homeownership schemes. Currently, the commonhold legislation prevents residential leases of longer than seven years from being granted within commonhold (although non-residential leases of any length are
permitted). In Chapter 12 we provisionally propose that a limited exception to the ban on residential leases should be permitted for shared ownership leases.

1.55 Additionally, we are aware, through discussions with stakeholders, that the ban on residential leases would also prevent the grant of lease-based “home purchase plans” in commonhold. Home purchase plans are a means of financing property purchases in a way which is compliant with Islamic Law. We therefore provisionally propose a further exception to the general ban on residential leases to accommodate lease-based home purchase plans in Chapter 12.

1.56 Mortgage lenders reported a lack of certainty surrounding the effect on their security of the termination of the commonhold by the unit owners and the insolvency of the commonhold association. Lenders also emphasised the importance of commonholds being adequately maintained in order to preserve the value of the asset over which they have a secured interest.

1.57 To address these concerns, Chapter 15 suggests measures to clarify that lenders will largely be unaffected by the termination of a commonhold by the unit owners. Additionally, in Chapter 7 we suggest measures which will better protect lenders in the unlikely event of a commonhold association’s insolvency. However, we consider that it would be preferable to avoid an insolvency situation in the first place. Throughout this paper, we provisionally propose a number of reforms which are aimed at preserving the solvency of the commonhold association. In particular, we suggest in Chapters 5, 9 and 10 that it should be mandatory for directors of the association to maintain a reserve fund for emergency and major works and to hold adequate public liability insurance. As explained above, we are also provisionally proposing to provide the association with greater powers to recover commonhold contributions. This will assist in addressing lenders’ concerns about the proper maintenance of commonholds as insufficient funds could lead to the deterioration of the property.

Looking to other jurisdictions, and the historic development of commonhold

1.58 As noted above, systems of ownership equivalent to commonhold are used extensively in other countries. In analysing the problems with the current law governing commonhold, and considering possible reforms to address them, we have considered the experiences of other jurisdictions and examined how they have addressed similar issues. We have also had the benefit of input from experts in those other jurisdictions, listed in Appendix 2.

1.59 We have prepared a summary of how the law operates in other jurisdictions, which we have published alongside this Consultation Paper.36 That summary sets out the law on a country-by-country basis, but the explanation of the law for each country follows the structure of this Consultation Paper.

1.60 We have drawn extensively on the approach of those other jurisdictions in the preparation of this Consultation Paper. Space only permits us to make occasional reference to other jurisdictions, but our summary of the law in other jurisdictions is

36 See Commonhold: Comparative Research.
structured to help readers identify which parts relate to the different chapters of this Consultation Paper.

1.61 In addition to an examination of other jurisdictions, we have also looked at the historic development of commonhold. Our summary of how commonhold developed is also published alongside this Consultation Paper. Again, this summary sets out the developments in the proposals for commonhold following the structure of this Consultation Paper.

THE WIDER CONTEXT

Commonhold and leasehold reform in the spotlight

1.62 We are carrying out our commonhold project against a particular backdrop. Our project has been prompted by renewed concerns about shortcomings of leasehold ownership and its scope for abuse.

1.63 Concerns have been raised about many aspects of the leasehold market. For example:

(1) high and escalating ground rents making homes unmortgageable and therefore unsellable, trapping owners in their homes;

(2) houses being sold on a leasehold, as opposed to freehold, basis. While, as discussed above, there may be good reasons for flats to be sold on leases, it can be less apparent why a house is sold on this basis other than to extract a profit;

(3) the absence of regulation of managing agents either in terms of their qualifications or the quality of their work;

(4) the charging by landlords of unreasonable permission fees to carry out alterations to a property;

(5) close relationships between property developers and particular conveyancers which may threaten the latter’s independence in advising clients seeking to buy leasehold properties from the referring developers; and

(6) landlords’ independence being compromised by the ability to obtain and keep commission from insurance providers, although the responsibility for paying for insurance lies with leaseholders.

1.64 As a result of the poor leasehold practices described above, calls for reform have become louder and more urgent. An All-Party Parliamentary Group on Leasehold and Commonhold Reform (“the APPG”) has existed since 2016. This group has been active in calling for leasehold reform and for the reinvigoration of commonhold as an alternative. The APPG’s membership has grown from 35 Parliamentarians in

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37 See Commonhold: Legislative History.

38 Houses may be sold on a leasehold basis in estates in order to impose positive obligations in respect of the upkeep of the estate. But that does not apply in all cases. In any event, reasons why, for legal purposes, a house may be sold as a lease do not require the lease to provide income streams to the landlord, beyond those needed to maintain the property or the estate.
September 2016 to 151 in June 2018. The APPG’s work has run in parallel with campaigning by the Leasehold Knowledge Partnership (“LKP”) for leasehold reform. LKP also acts as the APPG’s secretariat.

1.65 Improving and facilitating homeownership is a priority for Government, and – as part of that – reform of residential leasehold law has become an increasing priority. Throughout 2017 and 2018, the UK and Welsh Governments announced various reforms, including:

1. proposals to ban the sale of houses on a leasehold basis;
2. proposals to limit ground rents to a nominal value when homes are sold on a leasehold basis;
3. plans to regulate the property agent sector, including letting, managing and estate agents; and
4. new restrictions on that properties that qualify for support from Help-To-Buy schemes in Wales and England.


In Wales developers would have to present genuine reasons for a house to be marketed as leasehold. In addition, starting ground rents would need to be limited to a maximum of 0.1% of the property’s sale value.
In July 2018, the Housing, Communities and Local Government Select Committee launched an inquiry into progress made on leasehold reform.\textsuperscript{45}

In addition, no doubt bolstered by the calls for change from the public and media, commonhold has been brought back on to the political agenda. The UK Government has stated that, in addition to pursuing leasehold reform:

we also want to look at ways to reinvigorate commonhold. ... This will help ensure that the market puts consumers’ needs ahead of those of developers or investors. We will also look at what more we can and should do to support commonhold to get off the ground working across the sector, including with mortgage lenders.\textsuperscript{46}

OVERARCHING POLICY CONSIDERATIONS

The context of our reform, as set out above, has led us to face several important policy questions. In particular, we have considered the extent to which unit owners can be offered the same degree of control as freehold house owners, and how far we can draw upon solutions offered by leasehold law and practice. We have thought carefully about how we might be able to prevent the same abuses which have been seen in leasehold from recurring in commonhold. We have also considered the role commonhold can play in responding to disasters, such as the Grenfell Tower tragedy.\textsuperscript{47}

Below we set out these policy considerations in more detail, explaining the conclusions that we have reached in each area.

To what extent does commonhold offer a form of ownership that is comparable to freehold house ownership?

As commonhold is a form of freehold ownership, it would seem natural that ownership of a commonhold unit should, as far as possible, be the same as ownership of a freehold house. To a certain extent, this is correct. However, there are ways in which commonhold units cannot be compared directly to houses. Commonhold units will often be structurally interdependent, such as flats within a block. The actions of individual unit owners therefore have greater potential to affect the others around them.
1.71 We are of the view that, wherever possible, commonhold should give owners similar levels of control and freedom as freehold house owners. However, in certain instances, it may be necessary to treat commonhold unit owners differently from freehold house owners in order to protect the other unit owners in the commonhold.

How far can we use leasehold law and practice as a comparator?

1.72 As leasehold is the current way of owning flats within a shared building, the temptation is to look at how issues have been addressed in leasehold law and practice. However, at the same time, we are conscious that commonhold is a different form of ownership, which has been created primarily in response to leasehold’s deficiencies. We have formed the view that a comparison with leasehold should not be automatic. Nor, however, should we be at pains to avoid leasehold practices altogether. Instead, we should look for the best solution. Certain practices in leasehold have arisen solely to address difficulties which arise where properties are interdependent. These difficulties will also need to be considered in commonhold. Where leasehold already offers the best solution, we adopt the same approach.

How far can commonhold prevent abuses which have been seen in the leasehold sector?

1.73 We are keen to prevent abuses which have been seen in the leasehold sector from being carried over into commonhold.

1.74 In our Consultation Paper, we make a number of proposals aimed at protecting unit owners from potential abuse. In particular, in Chapter 8 we provisionally propose making further amendments to the layout of the CCS to make it easier for prospective purchasers to identify any unusual terms, or terms that would cause them concern because of their particular interests and intended use of the property. We also provisionally propose in Chapter 14 capping the interest which may be charged on late payments of commonhold contributions. This protection could also be extended to cap other fees which might be chargeable by the commonhold association. However, given the fact that unit owners themselves are responsible for managing the building (or appointing an external director or manager), usually there will not be the same incentive to charge homeowners unnecessary fees. Given the flexibility of the CCS, which is set out in statute, Government would also be able to intervene by statutory instrument to stop any abuses which may arise in the future. Additionally, when deciding how best to accommodate mixed-use and multi-block commonhold developments, we have preferred options which better facilitate consumer protection.

1.75 However, commonhold is not, in and of itself, intended to be a consumer protection regime. There are instances where we have had to conclude that commonhold is unable completely to prevent abuse. For instance, our commonhold structure cannot prevent developers from referring prospective purchasers to selected conveyancers who might not advise purchasers independently. Broader concerns such as this cannot be resolved within the legal framework of commonhold.

1.76 It may be possible to follow the approach of other jurisdictions and create a regulatory body to oversee the operation of commonhold. The purpose of this regulator could be to ensure that good practice is followed. For instance, the regulator might have to approve any new CCSs to ensure that they comply with commonhold legislation and do not include any unfair terms for future homeowners. Such a regulator could have a
dispute-resolution role, seeking to mediate or adjudicate certain disputes before they reach the Tribunal or court. Alternatively, or additionally, the body could have an advisory function. Unit owners would be able to refer questions to the body about their rights and obligations, which in turn could hopefully prevent unnecessary disputes within commonhold. Additionally, it would be helpful for our new commonhold model, once implemented, to be accompanied by a good-quality consumer guide. However, whether there is a role for a public body would be a matter for Government to consider as part of its wider plans for the reinvigoration of commonhold and are not reforms that fall within the scope of our work.

What role can commonhold play in responding to disasters such as the Grenfell tragedy?

1.77 On 14 June 2017, the 24-storey Grenfell tower block in West London caught fire, claiming the lives of at least 72 people, although members of the local community suggest the figure is much higher. The rapid spread of the fire at Grenfell Tower has been attributed to flammable cladding on the outside of the building.

1.78 Following Grenfell, MHCLG publishes monthly updates on the number of high rise buildings which are suspected to have flammable cladding. As of 31 October 2018 there were stated to be 457 residential and publicly-owned buildings in England over 18 metres high which, due to their cladding, would be unlikely to meet building regulations guidance. Of these, 168 of the blocks are publicly-owned or managed in the social sector by local authorities or housing associations, with the remaining 289 being privately-owned residential blocks, including hotels and student accommodation.

1.79 Replacing flammable cladding has proven to be an extremely complicated and costly process. The question of who should meet these costs has been described as “a legal quagmire”. In some instances, the costs have been covered by developers who originally installed the cladding, or by the National House Building Council (“NHBC”), which provides warranties and insurance for newly built or converted properties. In the absence of intervention by developers or the NHBC, the costs will fall either on the freeholder or the leaseholders.

1.80 As a matter of law, the leaseholders may be liable to pay for remedial works under the terms of their lease. It has been argued, however, that it is morally objectionable to make leaseholders pay these significant sums (often amounting to tens of thousands of pounds each). If costs are passed on but leaseholders cannot pay these sums, they

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49 Figure quoted by James Brokenshire MP, Hansard (HC), 16 May 2018, vol 641, col 317.

50 Additionally, “waking watch” fire marshals have been employed to guard against the risk of fire at a number of sites, pending the removal of flammable cladding. The cost of such a service has been reported in some cases to be around £4,000 a week. House of Commons briefing paper, Leasehold high-rise flats: who pays for fire safety work? (May 2018) http://researchbriefings.files.parliament.uk/documents/CBP-8244/CBP-8244.pdf.

may need to sell their properties or risk their property being forfeited by the landlord for non-payment.

1.81 On 18 May 2018, Government announced that it would meet the reasonable costs of social landlords removing and replacing flammable cladding. In the private sector, Government has indicated that building owners should:

- do all they can to protect leaseholders from costs relating to interim measures and cladding remediation – either funding it themselves or looking at alternative routes such as insurance claims, warranties or legal action.

However, Government’s announcement creates no more than a “moral duty”. Further, there may be instances where building owners cannot afford the works, especially where the leaseholders own the building collectively, after having collectively enfranchised.

1.82 We have considered how commonhold may respond to tragedies such as Grenfell. In Chapter 8 we consider how Government will be able to respond to changing health and safety standards more readily, by amending the prescribed terms of the CCS. An independent regulator could also play a role in ensuring that buildings standards have been met. Additionally, in Chapter 11, we consider the options that will be available to a commonhold association to raise financing for emergency events. These options are intended to place a commonhold association in a better position to respond to emergencies than leaseholders who own the building collectively.

1.83 Following Grenfell, an independent review of building regulations and fire safety was carried out by Dame Judith Hackitt. The final report of this review was published in May 2018, and set out recommendations for a new regulatory framework. Government discussions are ongoing as to how best to implement these recommendations. We are awaiting the outcome of these discussions, and will consider any new regulatory framework and recommendations when preparing our final report.

IMPACT OF OUR PROJECT

1.84 The different options for reform that we present in our Consultation Paper will have financial and non-financial implications for landlords, leaseholders, future homeowners, and for the wider property market and economy. Government will undertake impact assessments in relation to any reform options that it pursues. This consultation provides an opportunity to gather evidence and data which can be used in the preparation of impact assessments. In Chapter 16, we ask questions about the impact of reform.

THE LAW IN WALES

1.85 The extent of Welsh devolution in relation to commonhold is unclear. “Housing” was expressly devolved to Wales in the Government of Wales Act 2006.52 Following the Wales Act 2017, rather than expressly devolving competence in certain areas, competence is devolved unless expressly reserved. The Welsh Assembly cannot modify “the private law”, which includes the law of property. But that does not apply if

the modification “has a purpose (other than modification of the private law) which does not relate to a reserved matter”. In other words, the Welsh Assembly has power to amend the law of property in Wales, provided the purpose of the amendment is related to a matter which is devolved (for example, housing).

1.86 Under our Protocol with the Welsh Ministers, the Commission will only undertake a project concerning a matter that is devolved to Wales if it has the support of the Welsh Ministers. To the extent that any of the matters in our Terms of Reference are devolved to Wales, the Welsh Ministers have indicated their support for the Commission undertaking this project.

1.87 Our project, therefore, is intended to cover both England and Wales, and to result, where reasonably possible, in a uniform set of recommendations that are suitable for both England and Wales. Nevertheless, in Chapter 16 we ask consultees whether any specific considerations in England or in Wales call for particular issues to be treated differently in England and in Wales.

STRUCTURE OF THIS CONSULTATION PAPER

1.88 We have divided this Consultation Paper into seven parts, considering each stage of the life of a commonhold, from creation, to operation, to termination.

(1) Part I: Introduction
Chapter 1: Introduction

(2) Part II: Converting to commonhold
Chapter 2: What is conversion to commonhold? – explains what we mean by conversion to commonhold and how it compares with buying “a share of the freehold” in a collective enfranchisement claim.

Chapter 3: The consent requirement – explains the difficulties currently caused by the requirement for unanimous consent to convert and sets out proposals to reduce the threshold of support required.

Chapter 4: The conversion procedure – sets out the procedure for converting a building from leasehold to commonhold and asks consultees whether the procedure could be made more effective.

(3) Part III: New commonhold developments
Chapter 5: Mixed-use and multi-block developments – sets out our proposals for making commonhold more usable for mixed-use and mixed-tenure developments.

Chapter 6: New commonhold developments and development rights – explains how developers may create new commonhold developments. It considers the

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53 Wales Act 2017, s 3 and schs 1 and 2 (and new schs 7A and 7B).
tension between providing flexibility to developers to complete the development, 
whilst providing certainty to owners who buy before the development is complete.

(4) **Part IV: The commonhold association**

Chapter 7: The structure of the commonhold association and insolvency – considers the corporate structure of the commonhold association, as well as the provisions governing what happens should the commonhold association become insolvent.

(5) **Part V: The commonhold community**

Chapter 8: The commonhold community statement – discusses the document which governs the commonhold community and sets out our overarching proposals for reform to this document. The individual rules of the CCS are considered throughout the other chapters of the Consultation Paper.

Chapter 9: Management and maintenance issues – looks at various issues which may arise in maintaining the commonhold building (or buildings), and in its internal management.

Chapter 10: Financing the commonhold – discusses the ways in which the costs of managing and maintaining the commonhold may be met.

Chapter 11: Responding to emergencies – considers ways in which the commonhold association may be able to obtain financing in order to respond to unforeseen events.

Chapter 12: The ban on residential leases within commonhold – possible exceptions – considers the restriction on granting residential leases of over seven years within commonhold, and how this impacts upon shared ownership housing, and home purchase plans.

(6) **Part VI: Enforcement and dispute resolution**

Chapter 13: Resolving disputes and the protection of minority interests in commonhold – examines the procedure for resolving disputes within the commonhold where the CCS has been breached. This chapter also considers whether measures should be introduced to protect the minority even where decisions have been validly taken by the majority in accordance with the CCS.

Chapter 14: Enforcement – looks at the actions the commonhold association can take where unit owners breach the CCS.

(7) **Part VII: Termination of a commonhold**

Chapter 15: Voluntary termination – considers how a commonhold may be brought to an end by the unit owners, and sets out proposals to ensure this process is usable but at the same time provides adequate protection for the minority.

(8) **Part VIII: Impact and application of reform**

Chapter 16: The impact and application of commonhold reform in England and in Wales.
Appendix 1: Terms of reference
Appendix 2: Members of technical advisory group
Appendix 3: Stakeholders we met with whilst producing this Consultation Paper
Appendix 4: Call for Evidence consultees
Appendix 5: The limited liability of the freehold management company
Appendix 6: Proposals requiring terms to be added to, or amended in, the prescribed CCS
Appendix 7: Example prescribed forms for dispute resolution

1.89 We have also produced three accompanying documents, published alongside this Consultation Paper. These are available on our website.

(1) Analysis of responses to the Call for Evidence and commonhold survey: this document summarises the responses we received to our Call for Evidence and survey of existing commonhold unit owners.

(2) Legislative history of commonhold: this accompanying document sets out our research into the policy decisions taken in previous commonhold consultations and draft Bills which preceded the current legislation.

(3) Comparative research on commonhold-equivalents in other jurisdictions: this research has provided us with ideas of reform and informed us what has and has not worked well in other jurisdictions.

ACKNOWLEDGEMENTS

1.90 We have held a number of meetings with individuals and organisation while we have been preparing this paper, and we are extremely grateful to them all for giving us their time and expertise so generously. We would like to extend our thanks to the members of our technical advisory group who are listed in Appendix 2; all the stakeholders listed in Appendix 3 who attended meetings with us; and all those listed in Appendix 4 who responded to the Call for Evidence; Sir Peter Bottomley MP, Jim Fitzpatrick MP and Sir Edward Davey MP (co-chairs of the All-Party Parliamentary Group on leasehold and commonhold reform); the LKP; Siobhan McGrath (President of the First-tier Tribunal (Property Chamber)); officials from the Ministry of Housing, Communities and Local Government, the Welsh Government, HM Land Registry and the Leasehold Advisory Service (“LEASE”).

PROJECT TEAM

1.91 The following members of the Property, Family and Trust team have contributed to this Consultation Paper: Matthew Jolley (head of team); Daniel Robinson (team lawyer); Christine Land (team lawyer); Nicholas Roberts (team lawyer); Emily Fitzpatrick (team lawyer); Gary Bennett (research assistant); and Rachel Preston (research assistant).
Part II: Converting to commonhold
Chapter 2: What is conversion to commonhold?

INTRODUCTION

2.1 Commonhold provides homebuyers with the opportunity to own a flat on a permanent, freehold basis. It also presents an opportunity for existing leaseholders of flats to change their ownership to commonhold in order to become freehold owners. Converting an existing building to commonhold currently requires the consent of everyone with a significant interest in the property, including the freeholder and all long leaseholders.\(^1\) The requirement of unanimous consent means that for all but the smallest blocks of flats, the opportunity to convert may be theoretical. Consultees have described the consent requirement as being almost impossible to satisfy.\(^2\)

2.2 The overall policy aim of our commonhold project is to “reinvigorate commonhold as a workable alternative to leasehold, for both existing and new homes”.\(^3\) If commonhold is to be available for existing leaseholders, we think that it is necessary to review the requirement for unanimous consent, since it creates a significant practical limitation on converting to commonhold.

2.3 In this chapter, we explain what we mean by “conversion to commonhold” and the practical consequences of conversion for existing homeowners. We introduce a simple worked example, variants of which are used throughout this Part. We also discuss how conversion compares with buying a “share of the freehold”, through a process known as “collective enfranchisement”. In Chapter 3, we consider the conditions that must be satisfied in order to convert to commonhold. We explain the current requirement for unanimous consent to conversion and consider whether, and in what circumstances, it may be possible to convert to commonhold without the consent of all interested parties. In Chapter 4, we consider the procedure for converting to commonhold, once the necessary conditions have been satisfied.

WHAT DO WE MEAN BY “CONVERSION TO COMMONHOLD”?

2.4 Conversion to commonhold involves two or more individuals who own separate properties in a building or larger development putting in place a commonhold structure to regulate the relationship between them and manage any common parts, in place of the existing ownership structure. Following conversion, the common parts of the building or development will be owned by a company (“the commonhold association”) of which the individual property owners will be members. The commonhold structure requires each separate property (referred to as “commonhold units”) to be held on a freehold basis. As flats are invariably held on a leasehold basis, conversion to

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1 A “long lease” is a lease which has been granted for more than 21 years.
2 See Commonhold: A Call for Evidence – Analysis of Responses, question 1.
3 Our full Terms of Reference can be found at Appendix 1.
commonhold will involve (i) leaseholders changing their property interest from leasehold to freehold and (ii) landlords losing their freehold interest.\footnote{As discussed in paras 2.20 to 2.21 below, where the freehold is not already owned by the leaseholders collectively, this would almost always involve the leaseholders paying to acquire the freehold.}

2.5 On conversion to commonhold, the identities of those who will become unit owners after conversion will be known from the outset. For example, where a block of flats is converted to commonhold, the existing leaseholders will become owners of the commonhold units after conversion. The 2002 Act therefore refers to the registration of a commonhold following conversion as “registration with unit owners”.\footnote{CLRA 2002, s 9.}

2.6 In contrast, where a developer builds a new block of flats with the intention of selling the individual flats as commonhold units, the identity of the new homeowners will not be known at the outset. The developer will therefore apply to register the commonhold “without unit owners”. The procedure for registration \textit{without} unit owners is described in Chapter 6.\footnote{Registration without unit owners would also be the correct procedure where an individual buys an existing building which is unoccupied and looks to sell the flats as commonhold units. It would also be the procedure to follow where an individual buys an occupied building, terminates the tenancies and sells commonhold units to new occupiers after registration. Whilst registration “without unit owners” is clearly the procedure intended to be used for new developments, there is currently nothing to prevent a developer from using the procedure for registration “with unit owners” for new developments. We discuss the implications of this in ch 6.}

2.7 In this Part, we use the example of leaseholders in a block of flats converting to commonhold. But it is not only leaseholders in blocks of flats who may wish to take advantage of the commonhold structure. For example, owners of separate houses on an estate may wish to use commonhold to manage the common parts between their houses (such as any driveways and parking areas). Additionally, an estate comprising a mix of blocks of flats and houses may wish to convert to commonhold. However, we anticipate that it will predominantly be leaseholders in blocks of flats who will seek to take advantage of the conversion process and such leaseholders are therefore the main focus of this Part.

\section*{CONSEQUENCES OF CONVERSION TO COMMONHOLD}

\subsection*{Existing leasehold structure}

2.8 To explain the consequences of converting to commonhold, it is necessary to summarise the position before conversion takes place. In the case of a block of flats, ownership will invariably be on a leasehold basis: see figure 1 below.
2.9 In this block of five flats, each flat is held by a leaseholder under a long lease. Each lease requires the leaseholder to pay ground rent to Z, an external landlord who owns the freehold of the block. Ground rent is a sum payable at regular intervals under the terms of the lease (usually every year) over and above the initial purchase price.

2.10 The relationship between the leaseholders and Z is governed by the terms of the leases, and by legislation. For example, the leaseholders will likely be required to pay service charges to Z under the terms of their leases. These charges would pay for Z’s costs of managing the block, such as the cost of insuring and repairing the block. Service charges payable to Z under the leases are subject to a statutory requirement that the costs are reasonable, and expenditure above certain levels requires Z to consult with the leaseholders in advance.

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7 A service charge is an amount payable by leaseholders under the terms of the lease to cover the cost of services provided by the landlord or a management company.

8 Service charges are regulated by sections 18 to 30 of the Landlord and Tenant Act 1985. To benefit from statutory protection, the service charges must reflect the landlord’s actual costs of providing the services, rather than being a fixed amount in the lease: Landlord and Tenant Act 1985, s 18.
2.11 The leaseholders have statutory “enfranchisement” rights, which are the subject of a separate Law Commission project.\(^9\) First, they each have a statutory right to extend their lease by 90 years. Second, some or all of the leaseholders can join together to purchase the freehold of the block from Z, a process known as “collective enfranchisement”.\(^10\) Exercising those enfranchisement rights requires the leaseholders to pay Z for the property interest that they acquire. It is the second of those rights – the right to collective enfranchisement – which is relevant to our discussion of conversion.

**Existing right to acquire the freehold: collective enfranchisement**

2.12 The leaseholders of the block can purchase the freehold of the building, without Z’s consent by the process of collective enfranchisement. After acquiring the freehold, such leaseholders are often referred to as owning “a share of the freehold”. The leaseholders must nominate a person (or persons) known as the “nominee purchaser” (which may be an individual – or individuals, or a company) to acquire the freehold on their behalf. In this example, the leaseholders set up a company, “T Co”, of which they are all shareholders (or members),\(^11\) which then compulsorily purchases the freehold from Z.\(^12\)

2.13 The process of collective enfranchisement, of itself, does nothing to change the leases. The leases will continue to exist following the collective acquisition of the freehold. The only immediate change to figure 1 above is that Z ceases to be the landlord and instead T Co becomes the landlord. After purchasing the freehold from Z, however, the leaseholders will usually arrange to vary the leases. T Co can grant new 999-year leases, without ground rent obligations and without requiring payment of a premium,\(^13\) to each leaseholder participating.

2.14 Figure 2 shows the outcome of a collective enfranchisement claim, where *all* the leaseholders join together to purchase the freehold from Z and then grant themselves extended leases.\(^14\) However, as we go on to discuss, collective enfranchisement is still possible even where a certain number of leaseholders do not join in with the process.

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\(^9\) A Consultation Paper, “Leasehold home ownership: buying your freehold or extending your lease (2018) Law Commission Consultation Paper No 238” was published in September 2018. We refer to this paper as “the Enfranchisement Consultation Paper”.

\(^10\) In our Enfranchisement Consultation Paper, we refer to the revised right to collective enfranchisement as “collective freehold acquisition”.

\(^11\) Where a company is set up as a “company limited by shares” the leaseholders will be referred to as “shareholders”. Where a company is set up as a “company limited by guarantee” the leaseholders will be referred to as “members”. We discuss this differences between these two types of company in ch 7.

\(^12\) Although leaseholders will typically set up a company to acquire the freehold, it is also possible to name up to four individuals who will act as the nominee purchaser. The problems that can arise if they do so are considered in the Enfranchisement Consultation Paper at paras 6.37 to 6.46.

\(^13\) A premium is a lump sum payable over and above any rent due under the lease.

\(^14\) Assuming the various criteria for a collective enfranchisement claim are satisfied. See ch 3, paras 3.19 to 3.20 below.
2.15 The outcome of a collective enfranchisement claim where all the leaseholders participate is that:

(1) the leasehold structure remains, but T Co is now the landlord. Whilst the leaseholders now, together, control the building, the two opposing interests (landlord and leaseholder) continue to exist. Effectively, the leaseholders “wear two hats”, as both leaseholders and shareholders in T Co;

(2) the relationship between the leaseholders and T Co continues to be governed by the terms of the leases, and by legislation. For example, the statutory regulation of service charges continues (meaning that T Co must still consult the leaseholders before incurring costs above a certain amount and the leaseholders would be able to challenge the reasonableness of service charge costs levied by T Co); and

(3) the leaseholders, as shareholders or members in T Co, have control over the management of the building (or could appoint a third-party to manage it), including, for example, setting the service charges.\footnote{In some cases, the management might already be undertaken through a residents’ management company (RMC) (or a “right to manage” company under the 2002 Act) of which the leaseholders are members. “RMC” is defined in the Glossary. Usually where there is an RMC it will have been the “third party” to each lease,}
Conversion to commonhold

2.16 In place of a leasehold structure (which collective enfranchisement retains), the leaseholders might instead prefer to convert to commonhold ownership: see figure 3. Following conversion to commonhold, each unit will instead be owned on a freehold basis and the common parts will be owned by a company of which the unit owners are members. Whilst after collectively enfranchising, leaseholders can gain control of the building, the relationship of landlord and tenant will continue to exist. As we explain in Chapter 1, the leasehold structure, and the legislation which applies to it (such as the service charge regime), assumes an adversarial relationship between those who own the flats and those who manage the building. Commonhold removes this adversarial system and replaces it with a new system specifically designed for collective ownership without an external landlord.

Figure 3: conversion to commonhold

2.17 If the leaseholders wish to convert to commonhold, the position following conversion would be as follows:

(1) the leaseholders would each own the freehold interest in their flat - they would become commonhold “unit owners”;

when originally granted, in addition to the landlord and the leaseholder. The Law Commission is currently carrying out a separate project to reform the right to manage.
(2)  the leaseholders’ property interests would no longer be time-limited, and they would not be required to pay ground rent;

(3)  unit owners would become members of a commonhold association, which owns and manages the common parts of the building;

(4)  there would be no requirement to pay service charges; rather, the commonhold association would demand “commonhold contributions” from the unit owners to cover the shared costs of (for example) maintaining the block and reserve fund contributions;

(5)  the leases, and the statutory regulation of leasehold ownership, would disappear. The mutual rights and obligations between the unit owners would instead be governed by the terms of a “commonhold community statement” (“CCS”), and by the statutory regulation of commonhold;

(6)  there would be no landlord controlling the building;

(7)  bespoke provisions, designed for the management of a building without an external landlord would apply;

(8)  two directors would be appointed by the unit owners (who could be the unit owners themselves or external third parties) to carry out the management functions of the commonhold association; and

(9)  the unit owners would be able to vote on decisions about the management of the building by majority (usually of over 50%).

FINANCING THE ACQUISITION OF THE FREEHOLD

The value of the freeholder’s interest

2.18  When flats are owned on a leasehold basis, the freeholder has a property interest in the block of flats. The freeholder could be an external private landlord, a social landlord such as a housing association, or a leaseholder-owned company.16

2.19  The freeholder’s interest is often very valuable:

(1)  The freeholder will usually have a right to receive ground rent from the leaseholders, which can range from a nominal sum to a large annual sum and may increase on a periodic basis.17

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16 Leaseholders may own the freehold collectively in a number of circumstances. In addition to exercising a collective enfranchisement claim, a developer may transfer his or her freehold interest to all the leaseholders on the sale of the last flat in the building. A freeholder may also sell the freehold to the leaseholders voluntarily, outside of the collective enfranchisement regime. Additionally, in certain buildings, leaseholders may have purchased the freehold under “the right of first refusal” set out in Part II of the Landlord and Tenant Act 1987 or have exercised their right under Part III of this Act to acquire the freehold due to the landlord’s failure to maintain the building. In many cases, although a majority of leaseholders will have participated in the decision to acquire the freehold collectively, not all of the leaseholders in the building will own a share of the freehold.

17 Average ground rents are estimated at £371 per annum for a new build and £327 for a property pre-2016: Ministry of Housing, Communities and Local Government, Implementing reforms to the leasehold system in
The freeholder may require sums to be paid in return for the performance of administrative tasks, such as giving permission for alterations to be made to the property.

The freeholder can also obtain premiums for granting lease extensions and/or granting new leases when existing leases expire.

(a) Leases are granted for a fixed period of time, for example, 99 or 125 years. At the end of that period, the leases expire. Leases lose value over time as their length reduces and are therefore referred to as “wasting assets”. At the same time, the freeholder’s interest (which is worth more when not subject to any leasehold interests) will increase. When the leases expire, the freeholder will be free to grant a new lease over the property, and can charge a premium for doing so.

(b) To avoid losing their property, leaseholders may exercise their statutory right to a lease extension, which involves paying the freeholder for a new lease, adding a further 90 years to their original term. Such new leases are granted with a nominal ground rent (referred to as a “peppercorn rent”) which will replace the ground rent previously payable. Leaseholders might alternatively agree a lease extension with the freeholder on a voluntary basis (that is, without invoking the statutory rights). In order to obtain a lease extension, leaseholders must pay a premium to the landlord and that right to receive a premium is a valuable right. The premium compensates the landlord for the loss of income received through the ground rent and for the fact that the property will be subject to a lease for an additional 90 years.

The effect on the freeholder of converting to commonhold

On conversion, the leaseholders acquire the freehold interest in their flat and the commonhold association acquires the freehold of the common parts. Converting to commonhold therefore results in the former freeholder losing his or her property interest. Under the current law, the freeholder must therefore consent to conversion to commonhold, and is only likely to do so if he or she is paid for the value of the freehold. If the freeholder does not consent, it will be necessary for the leaseholders to exercise the statutory right to collective enfranchisement in order to acquire the freehold from Z before they can convert to commonhold.

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18 The Enfranchisement Consultation Paper considers whether the length of a lease extension should be increased (see paras 4.39 to 4.41).

19 Many long leases specify an annual ground rent of a peppercorn. Strictly, the landlord in these cases could require the leaseholder to provide him or her with a peppercorn annually, but invariably this is not demanded. A peppercorn rent is used in circumstances where it is deemed appropriate for there to be no substantive rent payable. Currently any statutory lease extension must be granted at a peppercorn rent.
Paying to acquire the freeholder’s interest

2.21 Leaseholders might only want to acquire the freehold through collective enfranchisement and retain the leasehold structure, or they might wish to go further and convert to commonhold. In either case, however, the leaseholders would need to pay for Z’s freehold interest. Following the example above, each leaseholder would contribute towards the cost of purchasing the freehold from Z. Figure 4 demonstrates how the purchase price might be paid.

Figure 4: purchasing the freehold

<table>
<thead>
<tr>
<th></th>
<th>Price payable to Z: £15,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>A pays £3,000</td>
</tr>
<tr>
<td>B</td>
<td>B pays £3,000</td>
</tr>
<tr>
<td>C</td>
<td>C pays £3,000</td>
</tr>
<tr>
<td>D</td>
<td>D pays £3,000</td>
</tr>
<tr>
<td>E</td>
<td>E pays £3,000</td>
</tr>
<tr>
<td>Z – Landlord</td>
<td></td>
</tr>
</tbody>
</table>

2.22 In figure 4, Z is entitled to be paid compensation of £15,000, in order for the leaseholders to acquire the freehold. That is the case whether the freehold thereafter is simply to be owned by a company of which the leaseholders (following a collective enfranchisement claim) are shareholders or members, or whether the leaseholders wish to go further and convert ownership of the block to commonhold. The sums used in figure 4 are, however, purely illustrative. The cost of buying the freehold will vary from building to building and will often be higher. Additionally, the amount each leaseholder may have to contribute can vary, for example, depending on the number of years remaining on the lease and the size of the flat. In our Enfranchisement Consultation Paper, we examine the options to reduce the premium payable by leaseholders whilst ensuring sufficient compensation is payable to the landlord.
DIFFICULTIES CONVERTING TO COMMONHOLD: NON-CONSENTING LEASEHOLDERS

2.23 The worked example above is deliberately simple. It will often be the case that one or more leaseholders (in addition to the freeholder) disagrees with the proposal to convert to commonhold, or agrees but is unable to raise the funds that are required in order to participate in the process. Particular difficulties arise where conversion to commonhold does not receive unanimous support. That is because conversion involves leaseholders’ property interests changing from leasehold to freehold, whereas leaseholders’ property interests remain the same after a collective enfranchisement. Conversion to commonhold without unanimous agreement may therefore involve leaseholders’ property interests being changed against their wishes. The approach of the current commonhold law is to avoid those difficulties, and protect all interested parties, simply by requiring that the freeholder, and all long leaseholders, consent to a proposal to convert to commonhold. The difficulties that arise where that requirement for unanimous consent cannot be satisfied are explored in the next chapter, and we use variants of the simple worked example above to demonstrate those difficulties and the potential solutions to them.

A comparison with collective enfranchisement

2.24 Before considering the existing requirement that all leaseholders consent to a conversion to commonhold, it is worth noting how the equivalent difficulty is addressed currently when the leaseholders seek to exercise the right of collective enfranchisement. Under the collective enfranchisement regime, it is not necessary for all leaseholders to consent to a proposal to acquire the freehold – indeed, a collective enfranchisement claim can go ahead if the leaseholders of just half of the flats in the building consent. The difficulties presented by non-consenting leaseholders are avoided because a collective enfranchisement claim retains the existing leasehold structure, and simply results in the identity of the freeholder changing. The leaseholders who participate in a claim acquire the freehold, and they therefore acquire the ability to vary the terms of their leases (generally by extending the leases and removing the requirement to pay ground rent). But the non-consenting leaseholders retain their leases. From their point of view, the only change is in the identity of their landlord. Instead of paying ground rent and other payments due under their leases to Z, such payments would be made to the other leaseholders with a share of the freehold. Given that non-consenting leaseholders’ property interests remain unchanged on a collective enfranchisement, enfranchisement can take place with the support of leaseholders making up just 50% of the flats. In our Enfranchisement Consultation Paper we explain that the requirement of 50% support is aimed at preventing a minority of leaseholders from acquiring and controlling the freehold.21

2.25 In the example above (figure 1), it might be that A, B, C and D want to exercise the right of collective enfranchisement, but that E does not wish to do so. Since a collective enfranchisement claim can be made by the leaseholders of just 50% of the flats in a

20 Provided these leaseholders are eligible to participate in a collective enfranchisement claim – referred to as “qualifying tenants” see further ch 3, para 3.45, and Enfranchisement Consultation Paper ch 7 paras 7.54 to 7.65 and ch 8.

21 Enfranchisement Consultation Paper, para 8.143.
building, a claim can go ahead without E’s consent. After the purchase, T Co might grant A, B, C and D new leases. E’s lease would remain unchanged: see figure 5. A, B, C and D would each have “a share of the freehold”. E would not.

**Figure 5: Treatment of non-consenting leaseholders after a collective enfranchisement claim**

2.26 Following the collective enfranchisement, A, B, C and D have 999-year leases with no ground rent (as in figure 2). By contrast, E retains his or her 99-year lease and continues to pay ground rent of £100 per annum.

2.27 The part of the premium payable to Z to acquire the freehold that is attributable to E’s flat (£3,000: see figure 4 above) would be paid by A, B, C and D.23

2.28 E would have a statutory right to extend his or her lease by 90 years but would not have any right to acquire a share in T Co.24 The ground rent and any premium payable for a lease extension would be paid by E to T Co.25

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22 Assuming the other criteria for collective enfranchisement can be satisfied. See ch 3, paras 3.19 to 3.20 below.

23 Or by a “white knight” investor who would then be granted a 999-year headlease of E’s flat, and therefore be entitled to ground rent and any lease extension premium.

24 In our Enfranchisement Consultation Paper, we propose the creation of a right for leaseholders who did not participate in a collective enfranchisement claim to participate at a later stage: Enfranchisement Consultation Paper, paras 6.144 to 6.159.

25 Or the “white knight” investor.
2.29 The outcome is similar to that set out in paragraph 2.15 above:

(1) the leasehold structure remains, but T Co is now the landlord. Effectively, A, B, C and D “wear two hats”, as both leaseholders and shareholders in T Co. E is only a leaseholder;

(2) the relationship between the leaseholders and T Co continues to be governed by the terms of the leases, and by legislation. The statutory regulation of service charges, for example, continues, and the result is that E (and even A, B, C and D) would be able to challenge the reasonableness of service charge costs levied by T Co; and

(3) the majority of leaseholders, as shareholders or members in T Co, have control over the management of the building.

2.30 Whilst the majority of the leaseholders now, together, control the building, the two opposing interests (of landlord and leaseholder) would continue to exist. Indeed, the opposing interests are more prominent, and have more potential to cause problems in the future, because E’s interest in his or her flat is a lesser interest than that of the other owners in the block: E has a shorter lease, must continue to pay ground rent, and has no say (through T Co) in the management of the block. A dispute by E about the reasonableness of the service charges demanded by T Co would, effectively, be a dispute between E on the one hand, and all of E’s neighbours on the other.

2.31 So whilst collective enfranchisement solves the problem of non-consenting leaseholders by allowing the claim to proceed without them, in doing so it creates other difficulties.

2.32 In the next chapter, we explore the equivalent position of non-consenting leaseholders when the proposal is to convert to commonhold, rather than to exercise the right of collective enfranchisement.

COMMONHOLD AND COLLECTIVE ENFRANCHISEMENT COMPARED

2.33 We set out in the table below (figure 6) the key differences between leasehold with an external landlord, collective enfranchisement, and commonhold. In the latter two scenarios, leaseholders (or a majority of them) will acquire the freehold; but the structure in place following acquisition will be different.
Figure 6: Key differences between leasehold with an external landlord, collective enfranchisement, and commonhold

<table>
<thead>
<tr>
<th>Issue</th>
<th>Leasehold with external landlord</th>
<th>Leasehold following collective enfranchisement claim</th>
<th>Conversion to commonhold</th>
</tr>
</thead>
<tbody>
<tr>
<td>The property interest</td>
<td>Leasehold – time-limited</td>
<td>Leasehold, and share of freehold (if participator)</td>
<td>Freehold – perpetual</td>
</tr>
<tr>
<td>Control</td>
<td>Lack of autonomy</td>
<td>Control through T Co (but only for those who participated)</td>
<td>Control through commonhold association</td>
</tr>
<tr>
<td>Existence of landlord</td>
<td>External landlord</td>
<td>T Co is a landlord, though controlled by (participating) leaseholders</td>
<td>No landlord</td>
</tr>
<tr>
<td>Payments for shared facilities etc</td>
<td>Service charge, regulated by lease and leasehold legislation</td>
<td>Service charge, regulated by lease and leasehold legislation</td>
<td>Commonhold contributions, regulated by CCS and commonhold legislation</td>
</tr>
<tr>
<td>Rules</td>
<td>Individual leases</td>
<td>Individual leases</td>
<td>CCS for all</td>
</tr>
</tbody>
</table>
Chapter 3: When should conversion be possible?

INTRODUCTION

3.1 Converting to commonhold involves property interests being lost or changed. Various people with an interest in the property (principally the freeholder, leaseholders, and leaseholders’ lenders) are therefore required to consent to conversion. That requirement, particularly in larger blocks of flats, can be practically impossible to satisfy. In this chapter, we explain the current requirement for unanimous consent to conversion and consider whether, and in what circumstances, it may be possible to convert to commonhold without the consent of all interested parties. Fundamentally, the requirements for converting to commonhold depend on the extent to which a person’s property interests are changed by conversion.

3.2 As explained in Chapter 2, it is already possible to overcome the problem presented by an external freeholder who does not consent to conversion to commonhold. Once certain qualifying criteria are met, the leaseholders can exercise the right of collective enfranchisement to compulsorily acquire the freehold and become the freeholder.26

3.3 Problems presented by leaseholders who do not consent are much harder to solve. Leaseholders may not consent to a proposal to convert to commonhold either because they object to commonhold ownership for one or other reason, or because – despite supporting a conversion to commonhold – they cannot afford to fund their contribution to the freehold purchase. We refer to such leaseholders as “non-consenting leaseholders”.

3.4 Consideration of changing the current requirement for unanimous leaseholder consent is inextricably linked to the property interest that non-consenting leaseholders will have after conversion. In this chapter, we explain that there are broadly two options as to what the property interests of non-consenting leaseholders could be. Which option is selected influences the question of whether, and in what circumstances, it should be possible to dispense with the current requirement for unanimous leaseholder consent.

THE CURRENT LAW

Who must consent to conversion to commonhold?

3.5 Under the current law, conversion to commonhold is only possible if all of the following persons consent.

(1) The freeholder.27 The freeholder’s consent is required because conversion will result in the freeholder losing his or her freehold interest in the building. Instead,
the freehold of the units will be owned by the unit owners and the freehold of the common parts will be owned by a commonhold association;

(2) Any leaseholders who own leases that were originally granted for more than 21 years.\textsuperscript{28} Leaseholders are required to consent to the conversion as, currently, on conversion to commonhold, all long leases are brought to an end and replaced with a commonhold unit;

(3) Any tenants who own tenancies that were originally granted for 21 years or less. Such tenancies are also brought to an end on conversion, but may be regranted following conversion. It will not be necessary to obtain the consent of such tenants if the following steps are taken.

(a) The tenant is granted a new tenancy on “equivalent terms” immediately following the conversion to commonhold. The new tenancy must be:

(i) of the same premises;

(ii) at the same rent;

(iii) for the same length of time as was remaining before conversion; and

(iv) on the same terms.\textsuperscript{29}

(b) The tenant’s right to a new tenancy after conversion has been protected by an entry on the Land Register.\textsuperscript{30}

(4) Any lenders who have an interest secured over any of the land which will become commonhold. This category includes, for example, banks who have mortgages secured against leaseholders’ leases of their flats. Lender consent is required in this scenario as their security will be lost when the leases are extinguished on conversion. It is likely that mortgage lenders will only consent to the conversion if they are repaid in full before the conversion or are prepared to accept new charges over the commonhold units after the conversion.\textsuperscript{31}

\textsuperscript{28} This includes any registered or unregistered owner of a leasehold interest of more than 21 years in the whole or part of the land to become commonhold: CLRA 2002, s 3(1)(b) and Commonhold Regulations 2004, reg 3(1)(b).

\textsuperscript{29} Save for any amendments to make the tenancy compliant with the terms of the CLRA 2002 and Commonhold Regulations: Commonhold Regulations 2004, reg 3(2)(a).

\textsuperscript{30} Or the land charges register in the case of unregistered land: Commonhold Regulations 2004, reg 3(1)(d) and (2).

\textsuperscript{31} As discussed at paras 3.154 to 3.157 below, currently not all lenders are willing to accept commonhold units as adequate security. However, this position may change if commonhold becomes a more prevalent form of ownership.
Giving, withdrawing and dispensing with consent

3.6 Consent may be given subject to conditions. For example, a lender may give consent only on the basis that it will be granted a new charge over the commonhold unit after conversion.

3.7 Consents are only valid for one year. Also, a person can withdraw consent at any time before the application to register the commonhold is made. There is no prescribed way of withdrawing consent.

3.8 A successor in title to a person who has consented is deemed also to consent. For example, if a leaseholder consents to the conversion and then sells his or her flat, the incoming purchaser will be treated as consenting to the conversion.

3.9 The court has the power to dispense with the requirement to obtain consent in particular circumstances:

(1) where the person whose consent is required cannot be identified or traced after all reasonable efforts have been made; and

(2) where a request for consent has been sent but no response has been received despite all reasonable efforts being made.

3.10 The court cannot dispense with the requirement to obtain a particular consent simply because the person is said to be acting unreasonably in refusing consent.

3.11 The court may make a dispensation order which is subject to certain conditions being fulfilled. For example, the court could require the applicant to take certain further steps to try to locate the person whose consent is required, before a dispensation takes effect.

CRITICISMS OF THE CURRENT LAW

3.12 In our Call for Evidence, we asked whether the requirement to obtain the consent of the freeholder, all leaseholders, tenants and lenders would create, or had created, a barrier to conversion. The vast majority of consultees (66 out of 69) responding to this question considered that it would create, or had created such a barrier.

32 Commonhold Regulations 2004, reg 4(3). If an application to register the commonhold is made but then withdrawn or rejected, the consents obtained in support of the original application will still be valid in support of a further application made within 12 months of the consents being given: Commonhold Regulations 2004, reg 4(6).

33 Commonhold Regulations 2004, reg 4(5).

34 In this case, it appears that the consent would bind the new purchaser automatically, even if the seller had not advised them of the consent. It would therefore be advisable for conveyancers to ask whether there is any conversion to commonhold pending and whether the seller has consented to the conversion.

35 Commonhold Regulations 2004, reg 5.

36 CLRA 2002, s 3(3)(a).

37 Two consultees advised said that the consent requirement was not the main reason for the failure of commonhold and one consultee explained that from an insurer’s perspective there is no issue with the actual conversion process: see Commonhold: A Call for Evidence – Analysis of Responses, para 1.1.
3.13 We now discuss each of these categories of person in turn. We consider whether the requirement of unanimous consent may be removed whilst still protecting each category of person.

PROTECTING FREEHOLDERS ON CONVERSION

Introduction

3.14 Currently, to protect the freeholder, conversion to commonhold is not possible without the consent of the freeholder. After conversion under the existing commonhold model, the freeholder will have no interest in the property. The freehold of the common parts of the building (or development) will be owned by the commonhold association, and the units (such as flats within a block of flats) will be transferred to the unit owners (the former leaseholders in the block). We explain in Chapter 2 that the freehold can be a valuable asset.\(^\text{38}\) The freeholder is unlikely to consent to the conversion unless he or she will be sufficiently compensated for the freehold interest.

Responses to the Call for Evidence

3.15 Twenty-two respondents to our Call for Evidence referred to actual or perceived difficulties arising from the need to obtain the freeholder’s consent to conversion. Several argued that freeholders are extremely unlikely to see conversion as being in their best interests, as it involves the freeholder giving or (more likely) selling his or her freehold interest to the leaseholders and losing the income streams received through leasehold. Only one consultee, the Association of Retirement Housing Managers, referred to a member’s personal experience of the freeholder being willing to sell the freehold on a voluntary basis, to enable the leaseholders to create a commonhold.\(^\text{39}\)

3.16 The evidence received from our Call for Evidence suggests that, in the majority of cases, where the freehold is not already owned by the leaseholders, the freeholder will be unlikely to consent to the conversion taking place.

The starting point to overcoming a lack of consent: collective enfranchisement

3.17 The 2002 Act does not set out any specific procedure for the compulsory acquisition of the freeholder’s interest in order to facilitate conversion to commonhold. In practice, however, leaseholders already may be able to overcome the freeholder’s lack of consent by first exercising their statutory right to collective enfranchisement in order to acquire the freehold. The collective enfranchisement legislation sets out the circumstances and terms on which it should be possible for leaseholders to acquire the freehold compulsorily.

3.18 By acquiring and taking control of the freehold through collective enfranchisement, the leaseholders can – as the freeholder – apply to convert the property to commonhold.\(^\text{40}\)

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\(^{38}\) Ch 2, para 2.19.

\(^{39}\) This was in a development comprising 29 bungalows and common parts: see Commonhold: A Call for Evidence – Analysis of Responses, para 1.11.

\(^{40}\) That does not overcome the problem of every leaseholder being required to consent, so leaseholders who did not participate in the collective enfranchisement can still prevent conversion to commonhold. The requirement for all leaseholders to consent is addressed below.
3.19 Subject to certain exceptions, the current basic qualifying criteria for collective enfranchisement are as follows:\(^{41}\)

1. the premises must be a self-contained building or a self-contained part of a building;

2. there must be at least two flats held by “qualifying tenants” (generally residential leaseholders who have been granted leases for longer than 21 years, as discussed further at paragraph 3.45, in the building (or part of the building);

3. at least two-thirds of the flats in the building (or part of the building) must be held by qualifying tenants;

4. the number of qualifying tenants who bring the claim\(^{42}\) must represent at least 50% of all the flats in the building (or part of the building); and

5. no more than 25% of the internal floor area (excluding common parts) may be occupied or intended to be occupied for non-residential purposes.

3.20 We are consulting on various changes to these basic qualification criteria in our separate project on leasehold enfranchisement.\(^{43}\) We also discuss expanding the right to cover estates, rather than individual buildings. That would allow several buildings on an estate to be acquired at the same time without the consent of the freeholder.\(^{44}\)

**Adopting the criteria for collective enfranchisement**

3.21 As explained above, where the freeholder does not consent to the conversion to commonhold, leaseholders already have a mechanism to acquire the freehold and overcome the need for freeholder consent. From the freeholder’s perspective, we do not think conversion to commonhold would create any additional concerns, over and above the compulsory acquisition of his or her property.\(^{45}\) We therefore provisionally propose that the freeholder’s specific consent to conversion should not be required where the leaseholders satisfy the qualifying criteria for collective enfranchisement set out above. This proposal will ensure that a streamlined procedure to “enfranchise and convert” will also be possible, as we now explain.

3.22 Where the freeholder does not consent to conversion to commonhold, currently, a two-stage route to conversion will always be necessary.

\(^{41}\) Leasehold Reform, Housing and Urban Development Act 1993, ss 1 to 10.

\(^{42}\) By signing a notice of claim (or “claim notice”) under our proposals to reform enfranchisement: see ch 4 para 4.21 of this Consultation Paper.

\(^{43}\) Enfranchisement Consultation Paper ch 8.

\(^{44}\) Enfranchisement Consultation Paper ch 6 paras 6.93 to 6.97.

\(^{45}\) Under the collective enfranchisement procedure, the freeholder may request new 999-year leases of any flats let to non-qualifying tenants. In paras 3.76 to 3.79, 3.101, 3.111 to 3.119 and 3.128 we discuss the circumstances in which the landlord may be able to obtain a leaseback or even become a unit owner on conversion to commonhold.
First, leaseholders will need to exercise the right to collective enfranchisement to obtain the freehold. In figure 2 (see Chapter 2), T Co – would acquire the freehold from Z on behalf of the leaseholders;

Second, the leaseholders with a share of the freehold (through T Co) will need to apply to convert to commonhold (to reach the position in figure 3).

3.23 In Chapter 4, we consider how this two-stage process could be streamlined into an “enfranchise and convert” procedure led by leaseholders. The procedure would incorporate the processes of collective enfranchisement (determining matters such as the extent of the property to be compulsorily acquired, and the premium payable for that acquisition) and conversion (such as registration of the commonhold community statement (“CCS”)). This streamlined procedure would enable leaseholders to acquire the freehold compulsorily and, at the same time, convert to commonhold. The streamlined procedure would be prevented, however, if the freeholder could block the conversion by refusing consent to conversion at the very end of the process when the freehold is to be transferred to the commonhold association. It would be a highly undesirable result if the freeholder could prevent conversion at the very end of the process, once a significant amount of time and money had been expended.

3.24 Under our proposals, once the collective enfranchisement criteria have been satisfied, the freeholder would not be able to prevent the acquisition of the property or the conversion to commonhold. In order to dispense with the requirement for freeholder consent, it is important that the qualifying criteria for collective enfranchisement can be made out. These criteria are designed to identify the conditions that should have to be satisfied before a group of leaseholders can compulsorily acquire the freehold. They have been set (and our proposals for their reform will be set) against the backdrop of the freeholder’s property rights, protected by Article 1 of Protocol 1 to the European Convention of Human Rights (“A1P1”).

3.25 If leaseholders could convert to commonhold (and compulsorily purchase the freehold as part of this process) with less stringent qualifying criteria than for collective enfranchisement, leaseholders might be able to circumvent the policy reasons behind the criteria for collective enfranchisement. Leaseholders could start a conversion claim (with less stringent qualifying criteria) and stop once they had acquired the freehold, without putting in place the commonhold structure. Alternatively, leaseholders may be able to convert to commonhold (with less stringent qualifying criteria) and then move back to a leasehold structure.

3.26 Our provisional proposals will inevitably mean that certain buildings will be prevented from converting. For example, it would not be possible to convert buildings to commonhold where more than 25% of the building is occupied for non-residential use (if that qualification criterion is retained). We acknowledge that commonhold has

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46 See Enfranchisement Consultation Paper paras 15.4 to 15.17 for a discussion of freeholders’ human rights.

47 In our Enfranchisement Consultation Paper, we provisionally propose that the 25% threshold should be retained. In addition, relying on the enfranchisement criteria will mean that, as it presently stands, it will not be possible to convert a building containing two flats to commonhold, where the freeholder only lets one of the flats out on a long lease. There would not be two or more flats let on long residential leases and the two-thirds requirement would not be satisfied: see para 3.19. In our Enfranchisement Consultation Paper, we
always had potential for purely commercial and mixed-use developments. In the future, it may be possible to introduce a separate conversion procedure, independent of the collective enfranchisement procedure, which does not include the same restrictions on non-residential use, as we now discuss.

Possibility of adopting different qualifying criteria in the future

3.27 Government is considering ways to incentivise commonhold. One way to do so could be to make it easier for leaseholders to acquire the freehold, by relaxing the qualifying criteria, but only on the basis that the leaseholders will convert to commonhold. If that approach were adopted, we think it would be necessary to:

1. create a separate conversion procedure, independent of the collective enfranchisement procedure, which adopts different qualifying criteria. As mentioned above, in this Paper we provisionally propose (in Chapter 4) a streamlined procedure which would incorporate all the processes necessary both to acquire the freehold (through collective enfranchisement) and convert to commonhold. An advantage of this approach is that if, at any stage, leaseholders no longer wish to convert to commonhold, they could still acquire the freehold (through collective enfranchisement) and stop at that point. However, if there were to be a separate conversion procedure (with different qualification criteria), leaseholders who change their minds and decide to acquire the freehold but retain a leasehold structure would need to terminate the claim and start a new collective enfranchisement claim; and

2. consider anti-avoidance mechanisms to prevent leaseholders dismantling the commonhold structure and reverting back to the leasehold structure after acquiring the freehold (see paragraph 3.25 above).

3.28 Our tentative view is that, at this point in time, there are advantages in not tying leaseholders into a conversion process once they have served a notice to acquire the freehold on their freeholder. Additionally, we think it would be preferable to provide leaseholders with a choice as to the structure they put in place after having acquired the freehold. However, it would be possible to revisit this position in the future, once our proposals for commonhold have been tested.

Conclusion

3.29 For the reasons set out above, our provisional view is that, if leaseholders want to convert to commonhold where the freeholder will not sell the freehold voluntarily or consent to conversion, it should be necessary for the leaseholders to satisfy (at a minimum) the criteria for collective enfranchisement before that freeholder’s consent can be dispensed with. Once the collective enfranchisement criteria have been satisfied, the freeholder would not be able to prevent the acquisition of the property or the conversion to commonhold.

ask whether an exception to these requirements should be made in the case of buildings consisting of two residential units. Such an exception would enable the “collective” freehold acquisition (the term used for the revised collective enfranchisement right) by the leaseholder of one unit where the other is retained by the freeholder of the building; see Enfranchisement Consultation Paper paras 8.160 to 8.166.
3.30 Conversely, if the freeholder does consent, we do not think it should be necessary for the leaseholders also to be required to satisfy the criteria for collective enfranchisement before they can convert to commonhold.

### Consultation Question 1.

3.31 In order to protect freeholders, we provisionally propose that it should only be possible to convert to commonhold if either:

1. the freeholder consents; or
2. the leaseholders satisfy the qualifying criteria for collective enfranchisement, and acquire the freehold as part of the process of converting to commonhold.

Do consultees agree?

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**PROTECTING NON-CONSENTING LEASEHOLDERS ON CONVERSION**

**Responses to the Call for Evidence**

3.32 Forty-eight consultees responding to our Call for Evidence considered that the requirement to obtain unanimous consent of long leaseholders creates a barrier to conversion.\(^{48}\)

3.33 As an example, Places for People said that “obtaining full engagement and/or unanimity from property owners on day-to-day matters is often very challenging, even on very small developments. Therefore, obtaining unanimity for such a legally significant step of converting to commonhold is likely to be even more so.”

3.34 Only three consultees considered that the requirement for unanimous consent of long leaseholders would not present an obstacle in their building. These leaseholders lived in small blocks of three, four and eight flats respectively.

3.35 Consultees offered a number of reasons why unanimity of leaseholders could be difficult to achieve. The main reason, given by 25 respondents, was the difficulty of contacting leaseholders and issues surrounding leaseholder apathy, especially in larger blocks where a significant number of flats may be bought to let. There will also be instances where leaseholders do not have the mental capacity to consent to the conversion, or blocks where leaseholders have recently died.

3.36 Ten consultees referred to concerns about the cost of converting, eight consultees referred to a lack of awareness and difficulty obtaining legal advice, and four consultees referred to leaseholders not wishing to be involved in the management of the building.

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\(^{48}\) 69 consultees responded to the question of whether the requirement to obtain the consent of the freeholder, all leaseholders, tenants and lenders and the freeholder would create, or had created, a barrier to conversion.
3.37 Throughout this Consultation Paper, we will be considering reforms which should make commonhold more attractive to leaseholders. However, we acknowledge that, even with these reforms, it will be extremely difficult to obtain the unanimous consent of leaseholders to conversion in all but the smallest blocks.

3.38 We consider it evident from the responses to our Call for Evidence that the requirement to obtain unanimous consent of leaseholders creates a significant obstacle to conversion. From this conclusion, the questions below need to be addressed.

(1) Should conversion to commonhold be possible without the unanimous consent of leaseholders?

(2) If so:

(a) which leaseholders should have a say on conversion to commonhold? (for example, where there is more than one leaseholder in respect of a particular flat); and

(b) what percentage of these leaseholders should be required to support the decision to convert? The answer to this question depends on whether and how non-consenting leaseholders’ property interests are changed following conversion.

We now consider each of these questions in turn.

**Should conversion to commonhold be possible without the unanimous consent of leaseholders?**

3.39 A number of consultees shared their views on this point in response to our Call for Evidence.

(1) Three consultees thought that the requirement for unanimous consent of leaseholders should be retained. A self-formed industry group\(^49\) argued that “residents have good reasons for opposing a change in the nature of their tenure and it would not be appropriate for their interest to be overruled by the decision of a majority”.

(2) Three consultees argued that the percentage support required to convert to commonhold should be reduced to 50%.

(3) A further three consultees did not argue for or against unanimity but said that any proposal to reduce the 100% requirement would require careful consideration. In particular, FirstPort\(^50\) said that protections would have to be in place to ensure that the rights and interests of objectors were not overridden by a (perhaps small) majority.

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\(^{49}\) This group, which calls itself the Leasehold Reform Group is an informal group of stakeholders in the UK housing market including Ground Rent Income Fund plc, HomeGround, Long Harbour, PGIM Real Estate and other institutional freeholders and freehold property managers.

\(^{50}\) FirstPort is a residential property management group.
3.40 Our view is that, in order to reinvigorate commonhold and make it a viable alternative to leasehold for existing leaseholders, it is necessary to reduce the percentage of leaseholder support required to convert to commonhold. However, we agree with stakeholders’ concerns that removing the unanimity requirement requires careful consideration of the position of those who do not consent to the conversion.

Consultation Question 2.

3.41 We provisionally propose that it should be possible to convert to commonhold without the unanimous consent of leaseholders.

Do consultees agree?

3.42 Should it be possible to convert to commonhold without the consent of all leaseholders, it will be necessary to decide which leaseholders should have a say on conversion to commonhold.

Which leaseholders should have a say on conversion?

3.43 We think it is logical that only those leaseholders who can participate in a claim to purchase the freehold as part of a collective enfranchisement claim should be able to acquire a commonhold unit and have a say on conversion.

3.44 Where the freeholder does not consent to the conversion, those wishing to convert will need to satisfy the qualifying criteria for collective enfranchisement, in addition to any further criteria for conversion.

3.45 Those eligible to participate in a collective enfranchisement are referred to under the current law as “qualifying tenants”. “Qualifying tenants” are predominantly tenants who have been granted a lease of over 21, although there are some exceptions.  

3.46 Linking eligibility to participate in a decision to convert to commonhold to the definition of “qualifying tenant” means that only those who have been granted a lease of over 21 years (referred to as “long leaseholders”) will be eligible to take a commonhold unit and have a say on conversion. We think this is a desirable result. In our Enfranchisement Consultation Paper, we propose to retain the 21-year threshold. We explain that this requirement serves to distinguish between those who are likely to have paid a substantial premium for a lease, and to separate out “owners” from “renters”. We consider that the same policy considerations apply here, and that only “owners” of a

51 Certain leases are deemed to qualify, even if they have not technically been granted for over 21 years. Where a lease of over 21 years comes to an end and the leaseholder is granted a further lease of the same property or part of it, he or she is deemed to have a long lease, regardless of the actual term of the second lease. Additionally, certain statutory continuation periods of long leases are included within the definition of a long lease: see 1993 Act, s 7(3) and (5) and Enfranchisement Consultation Paper paras 7.59 to 7.60. We propose to maintain the same approach in our Enfranchisement Consultation Paper, albeit with some minor amendments: see ch 8 paras 8.68 to 8.72.

52 Enfranchisement Consultation Paper, paras 8.62 to 8.67.
lease, rather than “renters” should be eligible to take a unit on conversion to commonhold. We discuss the position of tenants with an interest of 21 years or less in paragraphs 3.148 to 3.152 below.

3.47 There are certain leaseholders who, despite having a lease of over 21 years will never be eligible to participate in a collective enfranchisement claim. In particular, non-residential leaseholders, such as business tenants, are not eligible. Under our provisional proposals, therefore, a business tenant would not be eligible to take a commonhold unit on conversion and would not have any say on conversion. However, as non-residential leases of any length are permitted within commonhold, such business leases could continue after conversion.

3.48 As a matter of policy, Government has decided that shared ownership leaseholders should not be eligible to participate in a collective enfranchisement prior to purchasing 100% of the value of the property. Shared ownership leaseholders, who have not yet staircased to 100%, would therefore not be able to become unit owners and would not have a say on conversion to commonhold. We provisionally propose in Chapter 12, however, that shared ownership leases should be allowed to continue after conversion to commonhold. We also make proposals at paragraphs 3.78 and 3.112 below which will ensure that the shared ownership relationship is preserved on conversion to commonhold.

3.49 Additionally, only one leaseholder in respect of a particular flat is a qualifying tenant. Where there are two or more residential leases of over 21 years in respect of a particular flat which would otherwise qualify, under the current law, it would be the leaseholder with the most inferior lease (usually also the shortest) who would be eligible to

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53 In addition to the exceptions discussed at paras 3.47 to 3.48 above, a leaseholder will be ineligible to participate in a collective enfranchisement where the landlord is a charitable housing trust and the flat forms part of the housing accommodation provided to it in pursuit of its charitable purposes. Additionally, the right will not be available where the lease is a sub-lease granted out of a superior lease which is not a long lease, in breach of the terms of the superior lease, and there has been no waiver of the breach by the superior landlord: See 1993 Act, s5(2). However, in our Enfranchisement Consultation Paper, we invite consultees views on whether these exceptions should be maintained: para 9.96.

54 Currently, a leaseholder will not be able to participate in a collective enfranchisement claim where the lease is a business lease within the meaning of Part II of the Landlord and Tenant Act 1954. However, reliance on the 1954 Act definition creates particular difficulties, as discussed in our Enfranchisement Consultation Paper: see paras 7.108 to 7.111. In our enfranchisement paper, we therefore propose a new test to exclude non-residential leaseholders from enfranchisement rights. We propose that, to be eligible to participate in a collective enfranchisement, the lease must be of a “residential unit” and the lease must permit residential use: see paras 8.37 to 8.54.

55 At paras 3.76 to 3.79 and 3.111 to 3.119 below we consider whether the freeholder of any flats let to commercial tenants would be eligible to take a new 999-year lease over such flats or become the unit owner.

56 As confirmed in the Terms of Reference for our enfranchisement project, prior to staircasing to 100%, shared owners should have a statutory right to a lease extension, but should not have the right to purchase the freehold of their house or participate in a collective enfranchisement. Government’s policy objective for preventing shared owners from participating in collective enfranchisement is to ensure the shared ownership model continues to operate as intended. In particular, the policy ensures that the staircasing provisions in the shared ownership lease cannot be circumvented by the tenant. Once a shared owner has staircased to 100% ownership, he or she will be able to participate in a collective enfranchisement. We discuss the position of shared owners following a conversion to commonhold in more detail in ch 12.

57 Leasehold Reform, Housing and Urban Development Act 1993, s 5(3).
participate. For example, in figure 7 below, if leaseholder A (with a lease of over 21 years) sub-lets his or her flat for more than 21 years to leaseholder B, only B would be eligible to participate in the collective enfranchisement. Linking eligibility to the definition of “qualifying tenant” will therefore mean that under our proposals, B would be the leaseholder who would take a commonhold unit and participate in a decision to convert.

Figure 7:

3.50 Practical difficulties arise unless the same person who participates in a collective enfranchisement claim (to buy a share of the freehold) also has a say on conversion and takes a commonhold unit. We provide an example below that illustrates our reasoning.

3.51 In figure 8 below, the freehold of the building is owned by Z. Z grants a 125-year lease of a flat to A. A then sub-leases the flat to B for 99 years. In this scenario, B would be eligible to participate in the collective enfranchisement and acquire a share of the freehold. On collective enfranchisement, both Z and A’s interests would need to be bought out (see figure 8 below). After collective enfranchisement, Z and A would no longer have an interest in the flat. It would not make sense, therefore, for A to be able to take the commonhold unit on conversion. Rather, B (who has paid for a share of the freehold), should be eligible to take a commonhold unit of the flat and should have a say on conversion.
3.52 Additionally, in Chapter 4, we set out proposals for a streamlined procedure for claiming the right to enfranchise and convert. The procedure would become administratively difficult unless the same people who have a say on enfranchisement have a say on conversion.

3.53 In conclusion, therefore, we think that only leaseholders who are eligible to participate in a collective enfranchisement should be able to take a commonhold unit and have a say on conversion to commonhold.

**Consultation Question 3.**

3.54 We provisionally propose that only leaseholders who are eligible to participate in a collective enfranchisement claim should take a commonhold unit and should be able to participate in a decision to convert to commonhold.

Do consultees agree?

3.55 We now consider what percentage of qualifying leaseholders should be required to support a decision to convert to commonhold.
What percentage of leaseholders should be required to support a decision to convert?

3.56 We think that the percentage of leaseholder support required for conversion must take into account the interests and rights that those not wishing to convert (the “non-consenting leaseholders”) will receive following conversion. For example, if the interests and rights of non-consenting leaseholders will not be substantially affected following conversion, conversion with a lower percentage of support is more justifiable. If, however, leaseholders’ interests are to change substantially after the conversion, then a higher proportion of leaseholders (if not all of them) should support conversion.

3.57 We see two possible outcomes following conversion to commonhold. Either:

(1) non-consenting leaseholders will be permitted to retain their leases following conversion to commonhold. In which case, at the very least, removing the unanimity requirement would result in leaseholders who do not consent to the conversion being required to live in a building governed by the commonhold structure that has been put in place against their wishes. It might be desirable to go further, however, by varying the terms of non-consenting leaseholders’ leases or the statutory rights which apply to them in order to accommodate better such leases within the commonhold model. Or;

(2) non-consenting leaseholders will be required to take a commonhold unit on conversion instead of their leasehold interest. Following conversion, the rights and obligations of these individuals would be governed by the CCS and commonhold legislation, rather than their leases and leasehold legislation. Additionally, as we discuss later in the chapter, it is likely that there will need to be a way for such individuals to pay for the increase in the value of their property, which will have changed from leasehold to freehold on conversion. We suggest one way of achieving this could be to place a charge over non-consenting leaseholders’ properties on conversion. The charge would ensure that those who had financed the freehold purchase on behalf of non-consenting leaseholders would be repaid from the proceeds of any subsequent sale.

3.58 Changing non-consenting leaseholders’ interests must be done with caution, and with consideration of leaseholders’ property rights under Article 1 of Protocol 1 to the European Convention of Human Rights (“A1P1”). We consider the application of A1P1 in more detail below.

Human rights considerations

3.59 If conversion to commonhold requires non-consenting leaseholders’ property interests and rights to be altered (either by making variations to non-consenting leaseholders’ leases or requiring them to take a commonhold unit), it will most likely interfere with leaseholders’ property rights. A1P1 gives every person the right to peaceful enjoyment of his or her possessions, which includes leasehold property interests.58 “Peaceful enjoyment” means that a leaseholder should be able to use his or her property as intended, without unreasonable interruptions.

3.60 However, A1P1 is not an absolute right; some interference may be justified. In order for the interference to be justified, the interference must be in pursuit of a legitimate aim and there must be reasonable proportionality between the aim sought to be achieved by the interference and the means used to reach this aim.\textsuperscript{59}

3.61 When considering whether the interference pursues a legitimate aim, the court will generally afford the country’s Government a wide margin of appreciation and will only intervene if the aim is "manifestly without reasonable foundation."\textsuperscript{60} The aim of facilitating commonhold as an alternative to residential leasehold could be a legitimate aim of Government. It may therefore be possible to justify varying non-consenting leaseholders’ property interests, provided that the interference is proportionate to the objective of facilitating conversion to commonhold.

3.62 When considering whether an interference is proportionate, the court will take a number of factors into account, including whether the person affected has been compensated. Where there has been deprivation of property, a total lack of compensation will normally constitute a disproportionate interference and is only justifiable in exceptional circumstances. Interferences with A1P1 which do not amount to deprivation, however, do not necessarily require the payment of compensation in order to be proportionate. There may be an argument that requiring a leaseholder to take a commonhold unit on conversion (and possibly to pay for this change of ownership in one way or another) would amount to a “deprivation of property”. However, none of the options that we present would result in leaseholders losing their homes. Rather, the leaseholders’ interest in the property would be varied to fit the commonhold model.

3.63 In addition, when weighing up proportionality, the court will consider whether the interference affects rights retrospectively. Any interference which retrospectively affects rights and obligations arising from pre-existing legal relationships may “undermine legal certainty more severely” and may therefore be harder (although not impossible) to justify.\textsuperscript{61}

3.64 In the context of conversion, generally speaking, the more significant the interference with non-consenting leaseholders' property interests, the harder it becomes to justify the interference.

\textbf{Threshold of leaseholder support – options for reform}

3.65 We now present two broad options for the treatment of non-consenting leaseholders, and the threshold of support which may be required, beginning with that which we consider to be less intrusive. That is not to say, however, that we consider the second, more intrusive option to be undesirable. In fact, consultees may consider the second option to be necessary to produce a more appropriate commonhold model.

\textsuperscript{59} Fredin v Sweden (n 1) (1991) 13 EHRR 784. Additionally, the interference must not impose an “individual and excessive burden”: Sporrong and Lönnroth v Sweden (1982) 5 EHHR 35.


\textsuperscript{61} Axa General Insurance Ltd v Lord Advocate [2011] UKSC 46 at [121] by Lord Reed.
3.66 The less intrusive option would be to permit non-consenting leaseholders to choose whether to retain their leasehold interest on conversion. Conversion under this option would require the support of leaseholders of 50% of the flats in the building (“Option 1”).

3.67 The more intrusive option is to require non-consenting leaseholders to obtain a commonhold interest following conversion, in place of their lease (“Option 2”). We think this option would require a higher percentage of support, and propose that leaseholders of 80% of the flats in the building should support conversion under this option.

3.68 Whilst it would theoretically be possible to produce two alternative procedures – with different thresholds – operating in tandem, we think to do so would be to add unwelcome complexity to the commonhold model. Legislation would have to work though the consequences of both options, which would necessarily lengthen the legislation.

**Option 1: Non-consenting leaseholders retain their lease following the conversion**

3.69 The first option is to allow qualifying leaseholders who do not want to convert to commonhold to retain their leasehold interest following the conversion to commonhold. Such leaseholders would therefore be able to choose whether or not to take a commonhold unit.

3.70 We set out below how we envisage Option 1 would operate and the advantages and disadvantages of this option.

**Threshold of support under Option 1**

3.71 Conversion under Option 1 would create a position similar to that following collective enfranchisement: see Chapter 2 paragraphs 2.24 to 2.30. Following a collective enfranchisement, leaseholders would retain their leases but the management of the block would change. Under conversion Option 1, non-consenting leaseholders would retain their leases, but the commonhold association would take over the management of the block. Consenting leaseholders would take a commonhold unit. We therefore consider that, should Option 1 be pursued, the same threshold of support as required in a collective enfranchisement claim should be required to convert. Namely, leaseholders of 50% of the flats in the building must support the decision to convert. In a collective enfranchisement claim, the threshold of 50% is aimed at preventing a minority of leaseholders from acquiring and controlling the freehold. We think the same policy considerations apply on conversion to commonhold.

3.72 Additionally, conversion to commonhold may require certain amendments to leaseholders’ statutory rights. For example, we propose below that leaseholders should be given a statutory right to become commonhold owners of their units at a later date and that this right should replace existing enfranchisement rights. Further, we think it may be necessary to prevent non-consenting leaseholders from exercising their statutory rights in order to take over the management functions of the commonhold association. We think that, in order to justify those changes, leaseholders of at least half of the flats in the relevant building should support conversion.

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62 See ch 2, para 2.24.

63 For example by exercising the right to manage or the right to appoint a manager under Part II of the Landlord and Tenant Act 1987.
3.73 If Option 1 is pursued, we therefore provisionally propose that it should be necessary for qualifying leaseholders of at least 50% of the flats in the building to support the conversion.64

3.74 If Option 1 is pursued, it would be necessary to amend the provisions of the commonhold legislation which require all leases, of any length, to be extinguished on conversion to commonhold. Instead, non-consenting leaseholders’ leases would continue automatically on conversion (although potentially subject to the variations set out above).

Who would own the units let to non-consenting leaseholders?

3.75 All flats would become commonhold units on conversion to commonhold. The freehold of non-consenting leaseholders’ units could be held:

(1) by the commonhold association; or
(2) by a company owned by those who have financed the purchase.

We discuss each of these options further in paragraphs 3.98 to 3.99 below.

Figure 9: a worked example of Option 1

<table>
<thead>
<tr>
<th>A worked example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taking the example in figure 1 in Chapter 2 above, assume that A, B and C want to convert to commonhold but D and E do not. Under our proposals for Option 1, it would be possible for A, B and C (being qualifying leaseholders making up at least 50% of the flats in the building) to convert the building to commonhold: see figure 9a below.65</td>
</tr>
</tbody>
</table>

Where A, B and C finance the conversion, the position following conversion would be as follows:

(1) A, B and C would obtain freehold, commonhold units so their interests would not expire.
(2) The common parts of the building would be owned by a commonhold association which has responsibility for managing the building.

64 Where a freeholder consents to sell the freehold to one or more leaseholders voluntarily (and, therefore, outside of the collective enfranchisement regime), the leaseholders will not need to satisfy the basic qualifying criteria for collective enfranchisement set out above and no minimum threshold of leaseholder support is required. These qualifying criteria are only in place to protect freeholders who do not agree to sell their interests voluntarily. However, we propose that even where the freeholder agrees to sell the freehold voluntarily, leaseholders who wish to convert to commonhold must still represent 50% of the flats in the building (but not any additional qualifying criteria). That is because, whilst the freeholder’s interest would not be affected in this scenario, the interests of the leaseholders in the building would be. At the very least, leaseholders would be required to live in a building governed by the commonhold structure, which they may not have agreed to. The threshold of support to convert means that there will always be a specified minimum number of leaseholders in the building who want to put the commonhold management structure in place.

65 If Z did not consent to the conversion, part of the conversion process would require them to acquire the freehold from Z through a collective enfranchisement claim.
(3) The commonhold association (or a company of which A, B and/or C are members (“T Co”)) would become the commonhold unit owner of flats D and E, and in turn would be D’s and E’s landlord. D and E would pay ground rent (and any premium to extend their lease or acquire the commonhold unit) to the commonhold association (or T Co).

(4) The management and maintenance of the building would be governed by the terms of a CCS. However, the commonhold association would still be bound by the terms of D’s and E’s leases, and the statutory regulation of leases. This would protect D and E from the commonhold association recovering costs which are not payable under the terms of their leases, for example for substantial works to the building or additional services.

Figure 9a: effect of conversion under Option 1

Who would own the units not let to qualifying tenants?

3.76 On conversion, certain units may be let to “non-qualifying tenants”. We explained above that some leaseholders will never be able to take a commonhold unit or have a say on conversion to commonhold. Such leaseholders are referred to as “non-qualifying tenants” and are predominantly leaseholders with leases which have been granted for less than 21 years, non-residential leaseholders and shared ownership leaseholders. Other units may not be let out at all.
3.77 Where the freeholder of a building has let a flat directly to a non-qualifying tenant, there would be no qualifying tenant holding an interest of over 21 years who would be eligible to take a commonhold unit on conversion. The freehold units of these properties could be held by the commonhold association. However, we propose, under Option 1, that it should be possible for the freeholder to request new 999-year leases of any flats not let to qualifying tenants. In our Enfranchisement Consultation Paper we go further and provisionally propose that it should be possible for leaseholders to require the freeholder to take new 999-year leases of flats let which are not let to qualifying tenants, in order to reduce the purchase price.\(^{66}\) We provisionally propose to adopt the same approach on conversion to commonhold.

3.78 It may, in some circumstances, be particularly important for the freeholder of the building to retain an interest in the flats let to non-qualifying tenants. For example, the freeholder of the building may be a local authority who has let out one or more of the flats on secure tenancies. Secure tenants benefit from a significant amount of statutory protection, especially when it comes to ending these tenancies. Secure tenants can lose their status and statutory protection if a person other than a local authority becomes their landlord.\(^{67}\) If leaseholders could buy the local authorities’ freehold interest over such flats, the secure tenants would lose their statutory security. We therefore propose that under Option 1, new 999-year leases should always be granted to local authorities and housing associations over flats let to certain statutorily protected non-qualifying tenants.\(^{68}\) In addition, we propose that new 999-year leases should always be available to freeholders who have granted shared ownership leases, in order to preserve the shared ownership relationship on conversion. The position of shared ownership leaseholders in commonhold is discussed in more detail in Chapter 12.

3.79 Whilst it would be possible for the freeholder to instead take the commonhold unit, this could place the freeholder in a difficult position. If the freeholder took a commonhold unit, he or she would be responsible for paying the commonhold contributions, the cost of which may not be recoverable under the terms of the agreement with the non-qualifying tenant.\(^{69}\) Instead, the terms of any new 999-year lease granted by the association to the freeholder following conversion should reflect the terms of the tenancy or lease between the freeholder and the non-qualifying tenant. The freeholder can thereby ensure any costs which are payable to the association are recoverable under the tenancy or lease with the non-qualifying tenant.

\(^{66}\) Enfranchisement Consultation Paper, paras 6.129 to 6.132. The Enfranchisement Consultation Paper also proposes giving leaseholders the right to require freeholders to take a leaseback of any flats let to leaseholders who have not participated in the collective enfranchisement claim.

\(^{67}\) Housing Act 1985, ss 79 and 80. Tenants will cease to be secure tenants if their landlord does not satisfy the “landlord condition” at s 80.

\(^{68}\) We set out the position of tenants in more detail below. In particular, we propose that tenancies of 21 years or less should not be extinguished but should automatically continue on conversion to commonhold.

\(^{69}\) This is a particular difficulty which arises under Option 2 below.
Temporary nature of Option 1

3.80 If non-consenting leaseholders are to retain their leasehold interest following conversion, we think that they should only do so as a temporary measure. That could be achieved in one or both of the following ways.

(1) Non-consenting leaseholders could be provided with a statutory right to purchase the freehold of their unit at a later date. That would replace leaseholders’ existing statutory right to seek an extension of their lease or participate in a collective enfranchisement claim.\(^{70}\) It would amount to an alteration of leaseholders’ existing statutory enfranchisement rights. Additionally, given their initial reluctance to support the conversion, it is foreseeable that such leaseholders may never want to become a member of the commonhold association. If these leaseholders are deprived of their right to a lease extension, they would be forced to make a decision whether to become a commonhold unit owner against their wishes or see their leasehold interest expire.

(2) If non-consenting leaseholders wish to sell their properties, incoming purchasers could be given the option of buying the commonhold unit and becoming a member of the commonhold association. It might be possible to go further and say that incoming purchasers should be required to buy the commonhold unit, rather than just the leasehold interest. Leaseholders would receive the value of their leasehold interest and any additional value would be paid to those who had financed the freehold purchase.\(^{71}\) Again, the latter option would involve altering the non-consenting leaseholders’ rights by limiting the way in which their property interest can be sold.

Advantages and disadvantages of Option 1

3.81 There are two main advantages to Option 1. First, it would be less intrusive upon those leaseholders not wishing to convert. Leaseholders may have legitimate reasons for not wanting to become a commonhold unit owner and may wish to retain the protections provided in their lease. Option 1 would therefore be easier to justify than Option 2 below in so far as it involves any interference with non-consenting leaseholders’ rights under A1P1.

3.82 Second, the lesser intrusion for non-consenting leaseholders would justify a lower threshold for support (we suggest 50%), and therefore make conversion more likely, in practice, to be achievable than with the higher threshold suggested for Option 2 or the current requirement of unanimity.

3.83 Conversely, there are two main disadvantages to Option 1. The first concerns the underlying purpose of commonhold. In Chapter 12 we explain why residential leases of more than seven years are generally prohibited in commonhold. This restriction did not form part of the original commonhold scheme envisaged by the 1987 Aldridge Report.\(^{72}\)

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\(^{70}\) Including the new right proposed in the Enfranchisement Consultation Paper for non-participating leaseholders to participate in a previous collective enfranchisement claim.

\(^{71}\) The “additional value” would effectively be the difference in value between the leasehold interest and the commonhold unit.

\(^{72}\) Commonhold: freehold flats and the freehold ownership of other interdependent buildings (1987) Cm 179.
It was felt that the powers of the commonhold unit owner should resemble (as far as possible) any other freeholder and that the unit owner should be able to grant leases of any length.

3.84 Since the Aldridge Report, however, successive Governments have rejected the existence of residential leasehold within commonhold. That is because commonhold is designed to overcome the shortcomings of leasehold ownership and “it is not appropriate to perpetuate a problem within the system designed to get rid of it.”

3.85 The continuation of leases within commonhold is a strong argument against Option 1. As one stakeholder suggested, it would be preferable for commonhold to be created as an entirely new system without any of the disadvantages of leasehold. Mixing the two tenures could reduce the effectiveness of commonhold and cause confusion between homeowners as to the differences between leasehold and commonhold.

3.86 However, given the significant role played by residential leasehold in England and Wales, it may be hard to avoid the situation where leasehold and commonhold co-exist. In particular, in Chapter 12 we consider whether exceptions to the prohibition on long leases should be made to facilitate shared ownership leases and lease-based home purchase plans. These exceptions would apply both where a building has converted to commonhold and in new commonhold developments. However, we acknowledge that, in the future, a new way of structuring these arrangements without using leasehold may be developed which would be better suited to the commonhold model.

3.87 The second disadvantage concerns the constraints that would be created by the leases of the non-consenting leaseholders. Allowing leasehold within commonhold would create a “pepper-potting” of different interests within the same building. In particular, the commonhold association would not be completely free to run the commonhold by majority vote. The commonhold association would be hamstrung by the obligations under the non-consenting leaseholders’ leases. In particular, it would be necessary to comply with various statutory obligations concerning the recoverability of service charges.

3.88 Unit owners may therefore decide only to provide services and carry out works the cost of which can be recovered under the terms of the non-consenting leaseholders’ leases. Alternatively, consenting unit owners could decide to carry out these works or provide these additional services anyway, but fund the cost themselves. It may be that certain costs will never be recoverable under the leases and will need to be funded by the consenting unit owners, such as administration costs of running the commonhold association. Leaseholders who have collectively enfranchised already encounter a similar difficulty.

3.89 Certain stakeholders have suggested that it should be possible to remove non-consenting leaseholders’ statutory right to challenge the reasonableness of costs. That

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74 Either the commonhold association would be bound as landlord, or if the commonhold unit was held by a company (or white knight investor), that company is likely to insist that the commonhold association agrees to conditions that prevent it from levying a commonhold assessment which could not, in turn, be recovered from the leaseholder.
could be coupled with a requirement for the leaseholders to pay a share of the commonhold contributions. The quid pro quo might be that non-consenting leaseholders would have a vote in the management of the commonhold association or an alternative right to make representations about the commonhold contributions in the same way as other unit owners.\textsuperscript{75} Such an approach would, however, involve altering the protections afforded to non-consenting leaseholders, which may be harder to justify. The end result could be a fairly significant change to non-consenting leaseholders’ existing position, and might in substance be closer to Option 2 (discussed below). Moreover, affording non-consenting leaseholders analogous rights to unit owners, without requiring them to take and pay for the commonhold interest itself, would reduce the incentive for leaseholders to consent to the conversion at the outset and could be unfair to those consenting.

3.90 Whilst Option 1 will make it easier for leaseholders to convert to commonhold, consultees have queried whether there would be any incentive to convert to commonhold if the unit owners will still be bound (directly or indirectly) by the terms of the leases. In Chapter 1, paragraphs 3.13 to 3.14, we explain some of the advantages that commonhold can offer to leaseholders who have already collectively enfranchised.

3.91 Where leaseholders have not yet collectively enfranchised, leaseholders would be able to follow a streamlined procedure for enfranchising and converting to commonhold. This possibility is explored in the following chapter. Leaseholders looking to buy their freehold would be able to choose how to own and manage their building after purchase; either they could collectively enfranchise and retain a leasehold structure, or obtain the individual freehold of their flats by establishing a commonhold.

Financing the freehold purchase under Option 1

3.92 On conversion to commonhold, the structure and exterior of the building and all other common parts will be owned by the commonhold association. Additionally, the freehold of all commonhold units which are let to non-consenting leaseholders will be owned by either by the commonhold association or a company set up by those financing the purchase (see figure 9a above). The commonhold association may also own any units not let to qualifying tenants, but under our proposals (see paragraph 3.77) the freeholder may be required to take 999-year leases over such units in order to reduce the purchase price.

3.93 In figure 4 in Chapter 2 above, we set out how the purchase price for acquiring the freehold on a collective enfranchisement claim is apportioned between the different flats. If D and E do not consent to conversion, their share of the purchase price (£3,000 each) will have to be funded.

\textsuperscript{75} Currently, directors are responsible for making an annual estimate of the income needed. Directors are required to consider any representations made by unit owners regarding the amount charged; however the directors cannot be forced to change the budget as a result. Members ultimately have the power to remove and replace directors if they are not listening to members’ concerns. In ch 10 we set out proposals to require the commonhold budget to be approved by a resolution of unit owners and consider a new pre-emptive right to challenge commonhold costs before they are incurred.
3.94 Under Option 1, non-consenting leaseholders’ share of the freehold may be financed in one of three ways. These options are the same as those available on a collective enfranchisement claim. We summarise how they would operate in figure 12 below.

(1) **Consenting leaseholders**

3.95 Those wishing to convert to commonhold (or one or more of them) could finance the purchase between them. The consenting leaseholders would therefore need to pay for:

1. the share of the freehold value attributable to their own flats, which will become commonhold units and their share of the freehold value of the common parts; and
2. a share of the freehold value of any other non-consenting leaseholders’ units and non-consenting leaseholders’ shares towards the freehold value of the common parts.

3.96 On conversion, those financing the purchase would be entitled to receive:

1. any ground rent payable under the terms of the non-consenting leaseholders’ leases;
2. the premium payable if any of the non-consenting leaseholders decide to buy the commonhold interest in their property at a later date; and
3. the additional value realised on the sale of any non-consenting leaseholders’ properties as a commonhold unit (see paragraph 3.80(2)).

3.97 The following mechanisms might be put in place to ensure that only those who have financed the freehold purchase stand to receive sums from the non-consenting leaseholders.

3.98 One option is for the commonhold association to own the units let to non-consenting leaseholders. That would alter the current role of the commonhold association to an asset-holding body, as opposed to a management body. As the commonhold association is not permitted to be a member of itself, the association would not be able to exercise the voting rights associated with the units let to non-consenting leaseholders. Any concerns about directors of the association being able to exercise a disproportionate amount of control over the association would therefore be alleviated. Where any non-consenting leaseholder (or his or her purchaser) acquires the commonhold interest, he or she would have to pay the premium to the commonhold association, which would then be distributed to the members of the commonhold association. The premium payable would have to reflect the incoming commonhold unit owner’s new right to receive ground rent and premiums (through the commonhold

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76 These sums would also need to be paid by a non-consenting leaseholder who later wishes to buy his or her landlord’s commonhold interest and buy into the commonhold model.

77 The right to a lease extension having been replaced by a right to acquire the commonhold interest: see para 3.80(1) above.

78 Commonhold Regulations 2004, sch 3 para 9. This option may, however, require an exception to be made to the general prohibition on the commonhold association distributing profits and assets to its members (which is only possible on termination): Commonhold Regulations 2004, sch 2 para 72.
association) in respect of any other non-consenting leaseholder. A similar approach is adopted when non-participating leaseholders negotiate with their neighbours to join a previous collective enfranchisement.

3.99 The alternative option is for those financing the non-consenting leaseholders’ shares to set up a separate company, solely for the purpose of receiving ground rent and premiums from the non-consenting leaseholders. This separate company could become the unit owner of all flats let to non-consenting leaseholders. As the company would be the landlord of the non-consenting leaseholders, ground rent, and any premium to acquire the commonhold interest, would be payable directly from the leaseholders to the company.

(2) Third-party funder

3.100 A third-party investor (often referred to as a “white knight”) could finance the purchase. This third-party funder would be granted a new lease (for example of 999 years) of non-consenting leaseholders' flats, superior to the existing leaseholders’ leases. Any ongoing ground rent due under the non-consenting leaseholders’ leases would be paid to the funder. Whilst it would be possible for the funder to instead take the commonhold unit, the same difficulty as discussed in paragraph 3.79 above would arise. The problem may be avoided under Option 1 by ensuring that the terms of any new 999-year leases granted following conversion reflect those contained in the non-consenting leaseholders’ leases.

Figure 10: financing from a third-party investor (X)
(3) Leaseback to freeholder

3.101 The leaseholders could negotiate granting the freeholder of the building (or require the freeholder to take) a new lease (for example of 999 years) of the units held by non-consenting leaseholders: see figure 11. This would reduce the purchase price payable by those wishing to convert.

Figure 11: financing by freeholder taking leasebacks of non-consenting leaseholders’ units

- A pays £3,000, owns commonhold unit, and is member of commonhold association
- B pays £3,000, owns commonhold unit, and is member of commonhold association
- C pays £3,000, owns commonhold unit, and is member of commonhold association
- D obtains 999-year leaseback (CA owns commonhold unit)
  - D retains 99-year lease, £100 p.a. ground rent
- E obtains 999-year leaseback (CA owns commonhold unit)
  - E retains 99-year lease, £100 p.a. ground rent

D & E pay service charge, ground rent and any premium (to buy out Z’s interest) to Z (as landlord)
In turn, Z pays service charge (under its lease) to the commonhold association
Summary

3.102 The various ways of financing the freehold purchase under Option 1 are summarised in figure 12 below.

Figure 12: summary of options for financing the freehold purchase under Option 1

<table>
<thead>
<tr>
<th>Option</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>By A, B and/or C. They would be entitled to receive the £100 per year ground rent from D and E, and any premiums payable by D and E.</td>
</tr>
<tr>
<td>2</td>
<td>By a third-party funder. This funder would be granted new, superior leases over the flats owned by D and E, and would be entitled to receive the ongoing ground rent of £100 per annum. If D and E decided to purchase their commonhold units in the future, they would need to compensate the funder for the loss of its 999-year lease which would need to be acquired at that stage.</td>
</tr>
<tr>
<td>3</td>
<td>A, B and C could negotiate granting Z (or require Z to take) new, superior leases over the flats held by D and E. This would reduce the purchase price for A, B and C. The result is that the £6,000 attributable to flats D and E never has to be raised and paid because Z's 999-year lease will reflect the value of his or her freehold interest. If D and E decide to purchase their commonhold units, they would need to compensate Z for the loss of his or her 999-year lease, which would need to be acquired at that stage.</td>
</tr>
</tbody>
</table>

Safeguarding non-consenting leaseholders under Option 1

3.103 We consider that Option 1 sufficiently protects the interests of those leaseholders not wishing to convert to commonhold. Non-consenting leaseholders will be able to retain the protections provided by the terms of their leases on conversion. These leaseholders will only be responsible for paying costs to the commonhold association (or other landlord) which are recoverable under the terms of their leases. Additionally, non-consenting leaseholders would retain the right to challenge the reasonableness of service charge costs demanded by their landlord. We do not think any additional protections would be necessary to protect a minority of non-consenting leaseholders on conversion to commonhold under Option 1 (aside from the general requirement proposed above that leaseholders of 50% of the flats must agree to conversion under Option 1).
Consultation Question 4.

3.104 If non-consenting leaseholders retain their leases following conversion to commonhold (which we call “Option 1”):

(1) We provisionally propose that it should be possible for conversion to take place with the support of long leaseholders of 50% of the flats in the building. Do consultees agree?

(2) We provisionally propose that non-consenting leaseholders should be provided with a statutory right to purchase the commonhold interest in their unit at a later date. Do consultees agree?

(3) We provisionally propose that the right to purchase the commonhold interest should replace non-consenting leaseholders’ statutory rights to obtain a lease extension and to participate in a collective enfranchisement. Do consultees agree?

(4) We invite the views of consultees as to whether a purchaser from a non-consenting leaseholder should be required to purchase the commonhold interest, as well as the leasehold interest.

(5) We provisionally propose that the leaseholders should be able to require the freeholder to take new 999-year leases over any flats not let to qualifying tenants and that such leases should automatically be granted over flats let to statutorily protected non-qualifying tenants and shared ownership leaseholders. Do consultees agree?

(6) We invite the views of consultees as to whether the non-consenting leaseholders’ share of the freehold purchase should be capable of being funded:

   (a) by the consenting leaseholders, through the commonhold association which holds the commonhold interest;

   (b) by the consenting leaseholders, through a company (owned by them) which acquires the commonhold interest;

   (c) by a third-party investor, who acquires a long lease of the commonhold unit superior to the non-consenting leaseholder’s lease;

   (d) by granting a leaseback to the freeholder (who may be compelled to accept the lease), who acquires a long lease of the commonhold unit superior to the non-consenting leaseholder’s lease; and/or

   (e) by any other means.
Option 2: Non-consenting leaseholders take a commonhold unit of their premises following conversion

3.105 Under Option 2, non-consenting leaseholders (who are qualifying tenants, see paragraph 3.45 above) would not be able to retain their leases following conversion. Instead, these leaseholders would be required to take a commonhold unit on conversion. They would be entitled to participate in joint decision-making in respect of the building like all other unit owners. This option would enable the commonhold structure to work as intended and would place converting leaseholders in the same position as if they had purchased a unit in a new commonhold development.

3.106 Pursuing this option would mean that non-consenting leaseholders would not be able to rely on any terms of their leases, or any statutory protection afforded to leaseholders (for example, to challenge the reasonableness of service charge costs). Instead, the leaseholders would become freehold owners of their flats and would have the rights and protections available in commonhold.

3.107 We now set out how we envisage Option 2 would operate and the advantages and disadvantages of the option.

Threshold of support for Option 2

3.108 As Option 2 is a more intrusive option than Option 1 for non-consenting leaseholders, our view is that, in order to be proportionate, a higher percentage of leaseholders should support conversion to commonhold than under Option 1.

3.109 Option 2 requires a careful balance to be struck. On one hand, it would not be appropriate for the interests of non-consenting leaseholders to be overridden by a small majority. On the other hand, it may not be fair for a small number of leaseholders to be able to block conversion to commonhold, which could be a desirable change for the majority of leaseholders.

3.110 We provisionally propose that, in order for non-consenting leaseholders to be required to take a commonhold unit, qualifying leaseholders of at least 80% of the flats in the building must support the change. Option 2 represents a significant alteration to leaseholders’ rights. The threshold of 80% means that the interests of those not wishing to convert cannot be overridden by a small majority. This 80% threshold reflects the level of unit owner support required to voluntarily terminate the commonhold, discussed.

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79 As explained in paras 3.47 to 3.48 above, there are certain leases of over 21 years which cannot be qualifying tenancies. For example, business tenants and shared ownership leaseholders are not qualifying tenants for the purpose of collective enfranchisement. Such leaseholders will not be eligible to take a commonhold unit on conversion to commonhold. Instead, business tenancies and, as we propose in ch 12, shared ownership leases, will continue on conversion to commonhold, even under Option 2. Currently, a leaseholder will also be ineligible to participate in a collective enfranchisement where the landlord is a charitable housing trust and the flat forms part of the housing accommodation provided to it in pursuit of its charitable purposes. Additionally, the right will not be available where the lease is a sub-lease granted out of a superior lease which is not a long lease, in breach of the terms of the superior lease, and there has been no waiver of the breach by the superior landlord. In our Enfranchisement Consultation Paper (para 9.96) we invite consultees’ views as to whether these exceptions should be maintained. If these exceptions are maintained, it would be necessary to consider making further exceptions to the existence of leases within commonhold following conversion under Option 2.
at Chapter 15.\textsuperscript{80} It is also a higher threshold than that which would be required to make a collective enfranchisement claim. There would therefore be situations in which leaseholders could collectively enfranchise with 50% support, but would not be able to convert to commonhold.

**Figure 13: a worked example of Option 2**

<table>
<thead>
<tr>
<th>A worked example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Using the example in figure 1 in Chapter 2 above, assume A, B, C and D want to convert to commonhold but E does not. Under our provisional proposals for Option 2, it would be possible for leaseholders A to D (being qualifying leaseholders of 80% of the flats in the building) to convert to commonhold without E's consent.</td>
</tr>
</tbody>
</table>

The position following conversion under Option 2 would be the same as that in figure 3 above. In particular:

1. A, B, C, D and E would each have a freehold interest in their flat as commonhold unit owners;
2. A, B, C, D and E would no longer hold leases and would not benefit from statutory protections provided to leaseholders.
3. A, B, C, D and E would become members of a commonhold association which owns and manages the common parts of the building;
4. A, B, C, D and E would be required to contribute towards the costs of the commonhold association through the payment of “commonhold contributions”.
5. A, B, C, D and E's mutual rights and obligations would be governed by the terms of a CCS, which would have to been agreed by A, B, C and D. As we will go on to discuss in paragraphs 3.138 to 3.141 below, the Tribunal may have a role to play in ensuring the terms of the CCS do not prejudice E. We discuss the preparation of the CCS on conversion in more detail in Chapter 4.
6. Two directors would be appointed by A, B, C, D and E (who could be the unit owners themselves or external third-parties) to carry out the management functions of the association; and
7. A, B, C, D and E, would be able to vote on decisions about the management of the building by majority (usually of more than 50%).

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\textsuperscript{80} Currently 80% of unit owners may force the termination of the commonhold against the wishes of the minority. However, the terms on which the termination could take place (for instance, how much each owner stands to receive from the proceeds of sale) would need to be approved by the court in the absence of unanimous agreement.
Who would own the units not let to qualifying tenants?

3.111 In paragraph 3.77 above, we propose that freeholders should be able (or perhaps required) to take new 999-year leases of any units not let to qualifying tenants. However, such “leasebacks” would not be permitted under Option 2. Instead we provisionally propose under Option 2 that the freeholder should be able to choose to take a commonhold unit of any flats not let to qualifying tenants. It may be possible to go further and say that leaseholders should be able to require freeholders to take the commonhold unit of any flats not let to qualifying tenants. Where the freeholder does not take the commonhold unit, the units could be held by the commonhold association after conversion.

3.112 As also explained above, it is important that certain freeholders are able to retain an interest in particular units following conversion. Secure tenants, for example, may lose their statutory protection should a person other than a housing association or a local authority become their landlord. We therefore provisionally propose that such freeholders should automatically become the unit owner in respect of any flats let to certain statutorily protected tenants on conversion. We also propose that any freeholder who grants a shared ownership lease should take the commonhold unit on conversion, to ensure the shared ownership relationship is preserved.

3.113 However, under Option 2, the freeholder could be placed in a difficult position. This difficulty would arise where a non-qualifying tenant is required to pay a variable service charge in addition to rent.\(^81\) In this scenario, the former freeholder, as unit owner, would only be able to recover from the non-qualifying tenant costs which have been reasonably incurred.\(^82\) However, the former freeholder, as unit owner, would be required to pay commonhold contributions, without any equivalent right to challenge the reasonableness of costs levied by the commonhold association. The former freeholder would therefore become responsible for paying costs to the commonhold association which may not be recoverable under the non-qualifying tenant’s tenancy agreement or lease.

3.114 This difficulty could also arise under Option 2 where a leaseholder who has sub-let his or her flat to a non-qualifying tenant, is required to become a unit owner on conversion to commonhold. We provide an example below which illustrates this difficulty.

3.115 Taking the example in figure 13 above, suppose that E had sub-let his or her flat to a sub-tenant, F, on a sub-tenancy of 20 years. A, B, C, D and E, as qualifying tenants holding leases of over 21 years, have a say on whether conversion to commonhold takes place.

3.116 Leaseholders A to D support the decision to convert but E does not. If E takes a commonhold unit (and E will be required to do so under Option 2), E will become a member of the commonhold association and will be required to pay the commonhold contributions. As E will no longer be a leaseholder, E will lose the rights in his or her lease and the right to challenge the reasonableness of service charge costs – his or her

\(^81\) A variable service charge requires a leaseholder or tenant to pay the landlord’s actual costs of providing services, rather than a fixed amount in the tenancy agreement or lease.

\(^82\) Landlord and Tenant Act 1985, s 19.
rights being replaced by the rights in the CCS and the new regime governing commonhold contributions (see Chapter 10).

3.117 At the same time, E will remain subject to the terms of the sub-tenancy agreement with F. F will be able to rely on the terms of his or her agreement which will set out which costs can and cannot be recovered from F. F will also benefit from the statutory protections associated with being a tenant, including the right to challenge the reasonableness of service charge costs. This could leave E in the position of being required to pay a commonhold contribution, despite potentially being unable to recover those sums from F under the terms of the sub-tenancy.

3.118 If non-consenting leaseholders are able to retain their leases following conversion to commonhold (Option 1), leaseholders who have sub-let their flats to non-qualifying tenants would be able to factor this potential difficulty into their decision to convert. Under Option 2, however, no long leases will be permitted within commonhold. Where the requisite 80% majority has been met, non-consenting leaseholders who have sub-let their properties to non-qualifying tenants will be required to take a commonhold unit on conversion and could be subjected to the difficulties outlined above. In turn, this difficulty may also negatively impact tenants. If the unit owner were required to pay sums to the commonhold association without being able to recover these costs, the unit owner would have an incentive to increase the rent or terminate the tenancy (if that is possible).

3.119 This disadvantage experienced under Option 2 could be mitigated in one of the following ways.

(1) A temporary restriction could be placed upon the sums which may be recovered from the unit owner until the non-qualifying tenancy expires. It may, however, be a long time before the tenancy expires, especially where the tenant benefits from statutory protection which limits the circumstances in which the tenancy can be ended. This approach would dilute the advantages of Option 2.83

(2) It may be possible to modify the non-qualifying tenant’s interest by removing his or her right to challenge service charges. Instead, the tenant could be given a right to make representations about the commonhold charges in the same way as other unit owners.84 However, this would be altering the tenant’s rights retrospectively and the tenant would not have had any say on the conversion to commonhold.

Other advantages and disadvantages of Option 2

3.120 The main advantage of Option 2 is its relative simplicity in terms of the ongoing management of the block. All unit owners would have the same type of interest following conversion, rather than a mixture of commonhold and leasehold interests. Commonhold would be able to work as intended with every unit owner subject to the terms of the CCS, without being hindered by the terms of any leasehold interests (subject to any exceptions which may be desirable, as discussed in Chapter 12). Although it may be

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83 See the discussion of being hamstrung by existing leases in the context of Option 1: para 3.97 above.
84 For example, in ch 10 we propose that unit owners should be able to approve the commonhold’s budget and that owners would have the right to make a pre-emptive application to the Tribunal in certain circumstances.
more difficult to convert to commonhold under Option 2, which could result in a lower take-up of commonhold, once established, the commonhold model would operate in a simpler fashion.

3.121 The main disadvantage of Option 2 is that it is a more significant interference with non-consenting leaseholders’ property rights. On the one hand, conversion to commonhold may be seen as “upgrading” a property right from leasehold to freehold. The non-consenting leaseholders would no longer have time-limited assets which lose value over time. Non-consenting leaseholders may therefore be in a better position under Option 2 when they come to sell their units.85

3.122 On the other hand, from a leaseholder’s perspective taking a commonhold unit may not amount to an improvement. A leaseholder may prefer not to be involved in the management of the building and may wish to retain the protections provided by his or her lease, and by the statutory regulation of residential leases. Additionally, it is likely that non-consenting leaseholders would be required – in one way or another – to pay for their share of purchasing the freehold of the building, as will now be discussed.

Financing the freehold purchase under Option 2

3.123 Similarly to Option 1, under Option 2, those wishing to convert to commonhold would need to find a way to finance the purchase of the freehold. This would involve paying for the share of the freehold value attributable to their own individual flats (and their share of the freehold value of the common parts), and a share of the freehold value attributable to units held by non-consenting leaseholders (and non-consenting leaseholders’ shares of the freehold value of the common parts).

3.124 The leaseholders would also need to finance the purchase of any units not let to qualifying tenants where the freeholder does not take the commonhold unit (see further paras 3.111 to 3.119 above).

3.125 Taking the example above where E does not consent to conversion, it is still necessary to fund the share of the freehold value attributable to E’s flat, which is £3,000 (see figure 4 in Chapter 2). E, as a non-consenting leaseholder, would be required to take a commonhold unit on conversion to commonhold. However, it is difficult to envisage how E could also be required to pay £3,000 for his or her upgraded commonhold interest at the point of transfer. Conversely, it is unlikely that those financing the purchase would be willing effectively to give £3,000 to E for E to acquire the commonhold interest.

A comparison with Option 1

3.126 It is worth pausing to compare the position of non-consenting leaseholders under Options 1 and 2. The loss sustained by non-consenting leaseholders by reason of their lease being a wasting asset is “crystallised” on conversion under Option 2. By contrast, under Option 1, the loss continues until the leasehold interest is converted to a commonhold interest (whether by the leaseholder buying in to the commonhold, or a purchaser being compelled to do so). The difference is explained in figure 14.

85 See para 3.126 and figure 14 below.
Option 1

Under Option 1, E – as a non-consenting leaseholder – retains his or her 99-year lease and continues to pay ground rent.

Each lease, at the point of conversion is worth £100,000. An additional £3,000 is required to buy the freehold of each flat. £15,000 would therefore need to be paid to purchase the freehold and convert each flat into a commonhold unit.

A, B, C and D fund the purchase, including E’s share of the freehold purchase, namely £3,000.

If E acquires the commonhold interest 20 years later, the purchase price will be based on the value (to A, B, C and D, as landlord) of E’s lease. Since E’s lease will now be shorter, the premium payable by E will be greater than £3,000. Say, the freehold value of E’s flat has increased to £275,000 and the premium is now £15,000. A, B, C and D will therefore have benefited from the wasting nature of E’s lease. They will have paid E’s freehold share of £3,000 but would have received a premium of £15,000 on the sale of E’s unit.

So the price of the freehold acquisition attributable to E’s flat is crystallised when E later acquires that freehold interest. By that point, the price may have increased significantly.

Option 2

Under Option 2, E – as a non-consenting leaseholder – obtains a commonhold interest in his or her flat immediately. E’s lease is worth £100,000.

A, B, C and D fund E’s share of the freehold purchase, namely £3,000. E’s commonhold interest is worth (say) £105,000.

If E sells his commonhold interest 20 years later, the purchase price will be based on the value of E’s commonhold interest. Assuming property prices have increased in the same way as under Option 1, the freehold value of E’s flat will now be £275,000.

We do not think that E should reap the benefit of acquiring the freehold, now worth £275,000 and funded by A, B, C and D paying £3,000, without somehow repaying that sum to A, B, C and D as discussed further below. However, under Option 2, E would only be required to repay this sum (plus any additional value as discussed below) and A, B, C and D and would no longer have benefited from E having a wasting asset.

Recouping the cost of funding non-consenting leaseholders’ share of the freehold purchase

3.127 We now consider how those wishing to convert to commonhold may be able to finance the purchase of units held by non-consenting leaseholders and subsequently recoup their investment.

3.128 Unlike the position in Option 1, it would not be possible to grant the freeholder or a third-party funder a superior lease over non-consenting leaseholders’ flats, so as to reduce
the purchase price. Nor would it be possible to allow or require the freeholder or third-party funder to take the commonhold unit of non-consenting leaseholder’s flats, subject to their long leases. That is because (subject to limited exceptions) long leases will not be permitted following conversion to commonhold under Option 2.

3.129 We think it would be possible to create a charge over the commonhold units taken by non-consenting leaseholders on conversion. This charge would secure the repayment of non-consenting leaseholders’ shares of the original freehold purchase when they come to sell their units. There are various ways in which the charge could be set.

1. The charge could be set as the fixed amount of the share of the freehold attributable to E’s flat – here, £3,000. But that would make no allowance for the fact that the funders are effectively providing an interest-free loan, which may not be repaid for many years.

2. The charge could be set as that same figure of £3,000 with the addition of a moderate rate of interest.

3. The charge could be viewed as an investment in property, so it could go up (or down) with house-price inflation.

4. As a variant on (3) above, the charge could be set as a percentage share in the value of the commonhold unit. For example, if E’s leasehold flat on conversion was worth £100,000, but the value of the commonhold unit was £105,000, the charge could be 5% of the ultimate sale price of the commonhold unit (so, following the worked example in figure 14, assuming the freehold value of Flat E in 20 years’ time is £275,000, the charge would be £13,750 (5% of £275,000)).

Who provides the funding?

3.130 We turn now to consider who would be able, or perhaps compelled, to provide the funding and, therefore, have the benefit of the charge. There are various options.

3.131 First, those wishing to convert could finance the purchase of non-consenting leaseholders’ units between them. In reality, there may be only a small proportion of cases in which the leaseholders are able to fund the share of any non-consenting leaseholders, in addition to their own share.

3.132 Second, the freeholder could be required to take a charge over non-consenting leaseholders’ units. Those wishing to convert would be required to finance only their share of the purchase at the point of transfer. The freeholder would not be paid any non-consenting leaseholder’s share at the point of transfer (which could amount to up

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86 Although it may be possible for the freeholder to take or be required to take a commonhold unit of flats which are let out on short tenancies, which we propose below, should continue following conversion to commonhold.

87 In ch 12 we propose to permit certain long leases, such as shared ownership leases, to continue on conversion to commonhold. See also n 54 above.

88 This charge may instead benefit a leaseholder with a superior interest to that of the non-consenting leaseholder. For example, if the freeholder grants a 999-year lease to A who sub-lets on a lease of more than 21 years to B. On conversion to commonhold, A’s interest would need to be purchased. In this scenario, the charge over B’s commonhold unit may be granted in favour of A.
to 20% of the flats in the building). Instead, the freeholder would be granted a charge over non-consenting leaseholders’ flats. As these flats are sold on as commonhold units, the freeholder would be paid the non-consenting leaseholders’ share from the proceeds of sale.

3.133 In some respects, deferring payment of the purchase price may not be a significant departure from freeholders’ current position. Currently, freeholders only stand to receive part of the value of their property at a future date, if and when a leaseholder seeks to extend their lease, for example. However, in other respects, what the freeholder stands to receive would be different. The freeholder would not receive periodic payments of ground rent. Nor would the freeholder benefit from the wasting nature of the lease, that is, the fact a lease tends to lose value over time, which increases the premium payable for a lease extension. Whether it is desirable, and acceptable in terms of A1P1, to require freeholders to take a charge will depend on the terms of that charge – namely, which option in paragraph 3.129 above is selected. For example, requiring a freeholder effectively to provide an interest-free loan (option (a) in that list) is unlikely to comply with A1P1.

3.134 Third, a lending institution or third-party funder could provide the necessary financing. However, there would need to be an incentive for these individuals to do so and to take a charge.

3.135 As noted above, the fairness of requiring freeholders to accept a charge, and its attractiveness to banks and third-parties, will depend on whether interest or “added value” can be attached to the charge. However, as the charge would be a non-consensual transaction from the point of view of non-consenting leaseholders, it would be necessary to ensure that non-consenting leaseholders are protected from exploitation. Potentially it would be going too far not only to require leaseholders to take a commonhold unit, but also to require them to pay additional amounts, over and above reimbursing their share of the freehold purchase. Additionally, it would not be desirable to create a situation in which non-consenting leaseholders’ properties could become vulnerable to repossession if they failed to repay any additional amount (such as interest) before the point of sale. On the other hand, if non-consenting leaseholders are not required to pay any additional sum, it may create a disincentive for them to agree to the conversion in the first place. Such leaseholders would essentially obtain an interest-free loan and would be able to take a freehold unit immediately and start enjoying the benefits of commonhold without having had to pay for it.

3.136 We think that a compromise could be a charge representing a percentage share in the value of the property (option (4) in the list above). This means that anyone who finances the purchase would be able to share in any increase in the value of the property over time. The leaseholder would also be able to benefit from any increase in the value of his or her interest, and would no longer be prejudiced by the wasting nature of their leasehold interest.

89 See n 21.
Priority of the charge

3.137 It is also necessary to consider the priority such a charge would have in relation to an existing charge which benefits a mortgage lender. We think it would be possible to provide that the mortgage lender should be repaid only from the leaseholder’s share on the sale of the property. Given that an existing mortgage lender’s original security was only over a leasehold interest, not the upgraded commonhold interest, the best way to maintain the status quo might be to give the new charge priority over an existing lender. As discussed in Chapter 14 providing lenders with security over a commonhold unit rather than a leasehold flat would also improve their position, as lenders will not risk losing their security on the forfeiture of the lease. However, we discuss measures to protect lenders on conversion to commonhold and, specifically whether lender consent should be required, in paragraphs 3.158 to 3.169 below.

Safeguarding non-consenting leaseholders under Option 2

3.138 As we have acknowledged, Option 2 represents a more significant interference with non-consenting leaseholders’ property rights. We therefore consider it necessary to introduce further safeguards to protect the minority of non-consenting leaseholders.

3.139 We provisionally propose that any application to convert to commonhold under Option 2, with less than 100% consent, should require the approval of the First-tier Tribunal (Property Chamber) or Residential Property Tribunal in Wales ("the Tribunal"). The Tribunal will confirm that the necessary consents have been obtained and that the terms of the CCS sufficiently protect the interests of the minority.

3.140 We provisionally propose that the Tribunal should only be able to reject the application if leaseholders provide insufficient evidence that the necessary consents have been obtained, or if the terms of the CCS do not adequately protect the interests of non-consenting leaseholders. We do not think the Tribunal should have a general power to overrule the wishes of the majority and prevent the conversion from taking place in other circumstances.

3.141 The Tribunal should have the power to propose amendments to the CCS which would safeguard the interests of non-consenting leaseholders and which would allow the conversion to proceed. The consenting leaseholders would be free to accept the amendments proposed by the Tribunal and continue with the conversion, or to reject the amendments and choose not to convert.
Consultation Question 5.

3.142 If non-consenting leaseholders are to be required to take a commonhold unit following conversion to commonhold (which we call “Option 2”):

(1) We provisionally propose that qualifying leaseholders of 80% of the flats in the building should be required to support the decision to convert. Do consultees agree?

(2) We provisionally propose that the leaseholders should be able to require the freeholder to take the commonhold unit of any flats not let to qualifying tenants and that freeholders should automatically become the unit owner in respect of any flats let to statutorily protected non-qualifying tenants and shared ownership leaseholders. Do consultees agree?

(3) We provisionally propose that it should be possible to place a charge over non-consenting leaseholders’ units to recover their share of the initial freehold purchase price upon future sale of their commonhold unit. Do consultees agree?

(4) If consultees do not agree, how should non-consenting leaseholders’ share of the purchase price be financed?

(5) We invite the views of consultees as to who should be able to provide such finance and take the benefit of the charge.

(6) We invite the views of consultees as to whether the charge should be set:

   (a) as a fixed amount, representing the non-consenting leaseholder’s share of the initial freehold purchase;

   (b) as that fixed amount, with interest;

   (c) as that fixed amount, adjusted in line with house price inflation;

   (d) as a percentage of the final sale price, representing the percentage increase in value of the non-consenting leaseholder’s property interest (from leasehold to commonhold) on conversion; or

   (e) in some other way.

(7) We invite the views of consultees as to what priority this charge should have in relation to any pre-existing charges.
Consultation Question 6.

3.143 Where a freeholder or non-consenting leaseholder, who has let his or her flat to a non-qualifying tenant on a variable service charge, is required to take a commonhold unit on conversion under Option 2, we invite consultees’ views as to whether:

(1) a cap should be placed on the amount of commonhold costs which are recoverable from the former leaseholder or freeholder, to reflect the costs that are recoverable from the non-qualifying tenant;

(2) the non-qualifying tenant’s rights should be altered so that he or she no longer has the right to challenge service charge costs after they have been incurred, but instead has the same rights to challenge commonhold costs as other unit owners; or

(3) any other approach would fairly protect and balance the competing interests of the leaseholder or freeholder, and the non-qualifying tenant.

Consultation Question 7.

3.144 Under Option 2, we provisionally propose that:

(1) those wishing to convert (with less than unanimous consent) should be required to seek the prior authorisation of the First-tier Tribunal (Property Chamber) or Residential Property Tribunal in Wales (“the Tribunal”); and

(2) the Tribunal should be required to authorise a conversion to commonhold unless:

   (a) the necessary consents have not been obtained;

   (b) the terms of the CCS do not adequately protect the interests of non-consenting leaseholders; and/or

   (c) the applicants refuse to adopt the Tribunal's proposed revisions to ensure the CCS sufficiently protects the interests of non-consenting leaseholders.

Do consultees agree?

Threshold of long leaseholder support – summary of options

3.145 We have presented two options as to how the threshold of leaseholder support could be set depending on the position in which non-consenting leaseholders are placed after conversion. The first would be to require leaseholders (who are “qualifying tenants”), making up 50% of the flats within the building to consent, provided that they are to retain their leasehold interest on conversion to commonhold (Option 1). The second would be
require leaseholders (who are “qualifying tenants”) of 80% of the flats within the building to consent, on the basis that all such leaseholders will be required to take a commonhold unit on conversion (Option 2). As explained above, we do not think it would be desirable to produce two alternative procedures operating in tandem.

3.146 Towards the end of this chapter, we ask consultees which option they prefer and why. The option chosen will also have implications on the requirement for lender consent, which is considered separately in this chapter.

3.147 Before looking at the requirement of lender consent, we first consider the position of tenants who have been granted leases of 21 years or less. Under our proposals, these tenants would not be “qualifying tenants” and would not be eligible to take a commonhold unit on conversion to commonhold.

PROTECTING TENANTS ON CONVERSION

3.148 Currently, to convert to commonhold, it is necessary to obtain the consent of tenants who have a tenancy originally granted for 21 years or less. That is unless such tenants will be regranted a new tenancy on equivalent terms following conversion and notice of this right has been registered at HM Land Registry.  

3.149 We think this approach creates an unnecessary administrative burden on those wishing to convert, and will escalate costs. Additionally, it has been noted that ambiguities arise where tenancies benefitting from statutory protection are automatically terminated on conversion. For example, assured tenants (who benefit from a regime of statutory protection, including how rent may be increased and how such tenancies may be terminated) will often have the right to a new, statutorily-created, rolling tenancy once any fixed term comes to an end. It is unclear whether the 2002 Act intended such tenancies to continue on a statutory basis following conversion to commonhold.

3.150 We think the difficulties outlined above could be avoided by providing that tenancies which were originally granted for 21 years or less will continue automatically on conversion to commonhold, rather than having to be terminated and regranted.

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90 In practice, where there is a tenancy of 21 years or less, this will mean that those wishing to convert have two options. One is to seek the express consent of the tenant. If consent is provided, the tenancy will be extinguished on conversion to commonhold, without any right to a new tenancy. It is likely that the tenant would expect compensation in return. If the tenant refuses consent, it will be necessary to regrant the tenant a new tenancy on conversion and to protect this right at HM Land Registry in order to allow the conversion to proceed. Alternatively, those wishing to convert need not seek the tenant’s consent but simply regrant the tenant a new tenancy, on equivalent terms following conversion and protect this right at HM Land Registry.

91 G Cowen, J Driscoll and L Target, Commonhold Law and Practice (1st ed 2005) paras 4.10.1 to 4.10.3.

92 An assured tenant is one who falls within the definition of the Housing Act 1988, s 1. The tenant must occupy the property as his or her only or principal home and the tenancy must not fall within a list of tenancies which cannot be assured, for example, where rent payable exceeds a prescribed amount.

93 As another example, the Landlord and Tenant Act 1954 provides business tenants who meet particular criteria the right for their tenancy to continue, unless terminated in one of the ways provided for under the Act (see Landlord and Tenant Act 1954, s 24). It is unclear what would happen to such tenancies on conversion to commonhold.

94 After conversion, a new residential lease of over seven years (see ch 12) could not be granted. But allowing a lease of up to 21 years to continue after conversion would be a transitional measure.
3.151 As the interests and rights of tenants will not be affected by conversion to commonhold, we therefore propose that the consent of such tenants should not be required to convert. This is consistent with our proposal above that only qualifying tenants with a lease of over 21 years should be able to take a commonhold unit and have a say on conversion.95

Consultation Question 8.
3.152 We provisionally propose that on conversion to commonhold, tenancies granted for 21 years or less should continue automatically on conversion and that the consent of such tenants should not be required in order to convert to commonhold.

Do consultees agree?

PROTECTING LENDERS ON CONVERSION

3.153 To convert flats to commonhold, it is currently necessary to obtain the consent of all lenders who have an interest secured over any of the flats.

Responses to the Call for Evidence

3.154 Thirteen consultees to our Call for Evidence referred to difficulties obtaining lenders’ consent to conversion. In our Call for Evidence, we noted that 70% of UK Finance members did not accept commonhold properties as a form of security for lending.

3.155 The Building Societies Association suggested it would be unlikely for every lender to consent to conversion, especially in larger buildings:

even where a building society may be willing to lend against a commonhold property, it is very unlikely that each leaseholder in the property will have the same lender… 70% of UK Finance members do not accept commonhold, so the chances of all the mortgage lenders in a particular development agreeing to conversion are slim.

3.156 We were also told that, whilst 70% of UK Finance members may not accept commonhold units as security, the position is not quite so stark as that statistic would suggest:

95 As an example of the difficulty which would arise if tenants of 21 years or less could take a commonhold unit on conversion: The freehold of the building is owned by Z who grants a 125-year lease of a flat to A. A then grants a sub-tenancy of the flat to B, for only 20 years (which B has no right to renew). In this case, B would not have a lease of over 21 years and could not be a qualifying tenant in respect of the flat. B would not be eligible to participate in a collective enfranchisement or buy a share of the freehold. Instead A would be the only “qualifying tenant” in respect of the flat. A would be able to acquire a share of the freehold on collective enfranchisement and would continue to be subject to sub-lease B. Only A should be eligible to take a commonhold unit and be counted towards a decision to convert. It would be an odd result if, after A having paid for a share of the freehold, B could immediately elect to buy out A's interest, without the agreement of A, in order to be able to take a commonhold unit of the flat.
the UK Finance Mortgage Lenders’ Handbook asks whether lenders would be willing to accept commonhold and a significant number of lenders indicate they would. These represent a broad cross-section of mortgage lenders that provided almost 60% of new lending in 2016 (the most recent year that figures are available). Other lenders would probably be prepared to offer mortgages on commonhold properties but have not made provision to because of the very low numbers of commonhold properties… Mortgage lenders are generally open to the possibility of lending on commonhold properties.96

3.157 Additionally, lenders have told us that the absence of forfeiture within commonhold provides a distinct advantage over leasehold.97 As to whether lenders’ consent should be required for conversion to commonhold, Redrow Homes98 and a self-formed industry group (the Leasehold Reform Group) thought it should:

[Mortgage lenders] have a contractual and moral right to withhold consent in relation to changes in the fundamental legal nature of their security… If a person has acquired a leasehold interest or secured a debt over such leasehold interest, it is not for third parties to vote them out of it or change the nature of that interest without that person’s consent.

**Is lender consent necessary?**

3.158 Currently, lender consent is required as, on conversion, lender security will be lost. Under the existing law, all leases will be brought to an end on conversion and so any charges granted over these leases will be extinguished. Under our proposals for Option 1, set out above, non-consenting leaseholders will retain their leases following conversion to commonhold. If non-consenting leaseholders retain their leases, such leases would continue automatically on conversion to commonhold and therefore any charges over these leases would also continue. Lenders with an interest secured over a lease which continues on conversion should therefore not be required to consent to a conversion to commonhold. A more difficult question arises as to whether lenders’ consent should be required when a leaseholder chooses or is required to replace his or her lease with a commonhold unit on conversion.

3.159 We consider there to be only two options for addressing the difficulties of obtaining lender consent. Either the commonhold unit could be treated as offering security which is equivalent to or better than the leasehold title, in which case the lender’s charge could transfer automatically from the lease to the commonhold unit without requiring the lender’s consent. Or, the lender’s consent should be sought whenever a leaseholder wishes (or is required) to take a commonhold unit and the charge should not transfer automatically. Under this second option, measures could be put in place to minimise the difficulty of obtaining the unanimous agreement of mortgage lenders in the building. We now discuss both of these options in more detail.

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96 Commonhold: A Call for Evidence – Analysis of Responses, para 7.4.

97 Forfeiture is explained in more detail in ch 14 but it provides landlords with a right to terminate the lease and take possession of the flat if the leaseholder breaches the lease terms. If the landlord successfully forfeits the lease, any security a lender has over the lease will also be lost (subject to the lender’s right to apply for relief from forfeiture).

98 A UK house builder.
3.160 First, it may be possible to argue that lenders’ security should transfer automatically from the lease to the freehold commonhold units (of those taking a commonhold unit) on conversion, in which case lenders’ consent would not be required. Under conversion Option 1, this approach would affect lenders of those leaseholders who consent to conversion as these leaseholders would take a commonhold unit on conversion. Under Option 2 above, it would affect all lenders, since all leaseholders (whether or not they consent) would be required to take commonhold units in place of their leases.

3.161 The automatic transfer of a charge from one interest to another is already provided for in enfranchisement legislation, where a long leaseholder of a flat exercises their statutory right to a lease extension. Whilst described as a lease “extension”, what happens as a matter of law is that the leaseholder gives up his or her existing lease (which is referred to as a “surrender”). The leaseholder is then “regranted” a new lease for the remaining length of the original lease plus an additional 90 years. The enfranchisement legislation provides for any mortgage over the existing lease to transfer automatically to the new leasehold interest.99

3.162 Currently, the law only provides for the automatic transfer of a mortgage where the leaseholder of a flat obtains a lease extension. Where instead a leaseholder of a house wishes to extend their lease, or buy the freehold, he or she needs to obtain a “deed of substituted security” from the lender. Under this deed, the lender consents to its security over the existing lease being substituted by (that is, exchanged for) security over the new lease or freehold title. In the Enfranchisement Consultation Paper, we propose that a deed of substituted security should not be required where the leaseholder of a house seeks a lease extension or to buy the freehold. However, where the leaseholder is looking to buy the freehold, the charge will only transfer automatically where the leaseholder has given written notice to his or her mortgage lender, and no objection has been received from the mortgage lender within 21 days.100

3.163 Our provisional proposals on enfranchisement reform are made on the assumption that a lender would generally prefer to take security over a new, longer lease or the freehold title in exchange for the existing lease. It may be possible to say that, by analogy, a lender should be willing to accept a freehold commonhold unit, in exchange for its security over the lease (subject to priorities: see paragraph 3.137 above). Such a freehold interest would not run out of time and would not be at risk of forfeiture. Rather than requiring lenders’ consent, therefore, lenders’ security could transfer automatically to new commonhold units on conversion.

3.164 In a previous commonhold consultation paper,101 the same issue of lender consent to conversion was considered. Rather than suggesting that charges could transfer automatically on conversion, Government envisaged the possibility of forcing a minority of lenders to accept a commonhold unit, if the majority would accept the security. An analogy was drawn with the position of leaseholders on conversion to commonhold. The conclusion was reached that if there should be a power of the court to override the

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99 Leasehold Reform, Housing and Urban Development Act 1993, s 58(4). HM Land Registry will automatically register the mortgage against the title of the new longer lease.

100 See Enfranchisement Consultation Paper, paras 11.174 to 11.175.

wishes of a minority of leaseholders and require them to take a commonhold unit “it would seem clear that the power of the court to override the objections of the minority should extend to overriding the objections of [mortgage lenders].”

3.165 Above, we present the option of overriding the wishes of up to 20% of the leaseholders in the building by requiring them to take a commonhold unit, if the remaining leaseholders want to convert. However, we do not agree that this provides an analogy for the position of mortgage lenders. Our proposals in respect of leaseholders are to ensure that the majority can obtain the freehold of their flats and not be blocked by a small minority. We think this is different from interfering with a lender’s commercial decision as to whether or not they will accept a commonhold unit as adequate security.

3.166 The second option would be to require the consent of all mortgage lenders when conversion will result in a leaseholder exchanging his or her lease for a commonhold unit. Consultees may be of the view that, whilst a commonhold unit is a freehold title, the nature of the interest is different from that of a freehold house. The difference stems from the fact that commonhold units will be interdependent and that control of the building lies with the unit owners collectively rather than a single freehold owner. Consultees may therefore consider that lenders should have the opportunity of refusing to accept a commonhold unit as adequate security.

3.167 In practice, if leaseholders are able to retain their leases following conversion to commonhold (Option 1 presented above), only those who wish to take a commonhold unit will be required to seek the consent of their lenders. However, if, on conversion to commonhold, all leaseholders (who are “qualifying tenants”) are required to take a commonhold unit (Option 2), then all lenders who have an interest secured on any of the leases would be required to consent.

3.168 Seeking lenders’ consent will be easier where the request is made by the borrower. If the lender’s consent is required but not forthcoming, the borrower can seek to source an alternative lender – and factor the cost of doing so into the decision whether to consent to conversion. A particular difficulty arises, therefore, under Option 2, in relation to the minority of leaseholders who would be required to take a commonhold unit against their wishes. Those non-consenting leaseholders may have purchased their flat with the assistance of a mortgage, and the mortgage lender may refuse to transfer its security to the new commonhold unit. It would be difficult to compel the non-consenting leaseholder (who is already being required to take a commonhold unit) to seek an alternative lender to allow that conversion to take place. In theory, the onus could be placed on the consenting leaseholders to source alternative finance for the non-consenting leaseholder, and even to compensate the non-consenting leaseholder if the process results in additional fees and any detriment to the non-consenting leaseholder (compared to the previous lending arrangement). We think, however, that it is impossible to do so. It would require the consenting leaseholders to access personal financial information about the non-consenting leaseholders, and require the non-consenting leaseholder to sign new lending terms against their will. It is also likely to be unattractive to the consenting leaseholders to take on such a task.

3.169 If lenders’ consent is necessary, the problems presented by non-consenting leaseholders being required to take a commonhold unit (and therefore potentially changing lender) create significant difficulties for Option 2. The option may be workable only through Government action to incentivise commonhold, which we now consider.

**Lenders’ willingness to finance commonhold**

3.170 To make it easier for leaseholders to convert to commonhold, Government could itself provide the necessary finance, where mortgage lenders do not support the conversion process. Alternatively, or additionally, it may be possible for Government to assist by encouraging lenders to accept commonhold units as adequate security, for example by indemnifying lenders. In other jurisdictions, Governments have intervened to ensure homeowners can access the necessary funding to buy commonhold units. For example, in America, mortgage lenders did not initially offer very attractive terms for the purchase of commonhold-equivalent units. Where mortgages were not insured against borrower default, lenders required purchasers to pay very large deposits. 103 In 1961, the Federal Government authorised the Federal Housing Administration ("FHA") to insure mortgages on commonhold-equivalents. 104 This allowed purchasers to avoid having to make large down payments when buying units.

3.171 It may, however, be unnecessary for Government to intervene to encourage lenders to accept commonhold units as adequate security. We hope that an increase in commonhold properties (either due to more commonhold developments being built or more leaseholders converting) will see an increased willingness for mortgage lenders to accept commonhold as adequate security. Additionally, many of the proposals for reform in this Consultation Paper are aimed at addressing lenders’ concerns and making commonhold units more attractive as security.

Consultation Question 9.

3.172 We invite consultees’ views as to whether it should be possible for charges to transfer automatically from the leasehold title to the commonhold unit title on conversion to commonhold, without requiring lenders’ consent.

**SUMMARY OF PROPOSALS**

3.173 In this chapter, we have proposed that, where the freeholder does not consent to the conversion to commonhold, it will be necessary for the leaseholders to satisfy (at a minimum) the qualifying criteria for collective enfranchisement. However, once these criteria have been made out, the freeholder would not be able to block the compulsory acquisition of the property or the conversion to commonhold.

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104 The FHA is a government agency which provides lenders with protection against homeowners (traditionally of low to medium income) defaulting on their mortgage.
3.174 Leaseholders who are “qualifying tenants” under collective enfranchisement legislation would be eligible to take a commonhold unit on conversion and would have a say on whether their building is converted to commonhold.

3.175 Unanimous consent of such leaseholders to convert would not be required. We present two options for how the percentage of leaseholder support could be reduced. The first would be a threshold of 50%, provided that non-consenting leaseholders are able to retain their leasehold interest on conversion to commonhold (Option 1). The second would be a threshold of 80% on the basis that non-consenting leaseholders (who are “qualifying tenants”) are required to take a commonhold unit on conversion (Option 2).

3.176 Both options have advantages and disadvantages. Option 1 perpetuates the shortcomings of leasehold ownership within commonhold, if only as a temporary measure. Option 2 is more intrusive to those leaseholders who do not wish to convert. As Option 2 is more intrusive, we propose that a Tribunal order should be required to authorise the conversion to commonhold where unanimous consent has not been achieved. The Tribunal would check that the necessary consents have been obtained and that the terms of the CCS sufficiently protect the interests of the minority.

3.177 Under either option, those wishing to convert to commonhold will need to find a way of financing non-consenting leaseholders’ shares of the freehold purchase price, in addition to their own shares. Under Option 1, these shares could represent up to 50% of the flats building. Under Option 2 non-consenting leaseholders’ shares could be up 20%. The financing options are different, in particular leasebacks will not be possible under Option 2. However, it may be possible to require the freeholder to take the commonhold unit of those flats not let to qualifying tenants.

3.178 Under Option 1, those financing the freehold purchase will be entitled to any sums due under non-consenting leaseholders’ leases (such as ground rent) and will be paid premiums if non-consenting leaseholders buy their commonhold interest or sell their property. Those financing the purchase would be able to benefit from the wasting nature of non-consenting leaseholders’ leases. Under Option 2, a charge could be placed over non-consenting leaseholders’ units to ensure those financing the purchase are repaid on the sale of the units. After conversion, non-consenting leaseholders would no longer own a wasting asset. The difference in value between a non-consenting leaseholder’s lease and the commonhold interest would largely be “crystallised” on conversion.

3.179 Tenants under a tenancy of 21 years or less will not have a say on conversion and will not be eligible to take a commonhold unit on conversion. Their interests would continue automatically on conversion to commonhold.

3.180 It should not be necessary to seek the consent of any lender who has a charge over a non-consenting leaseholder’s lease which will continue under Option 1. Where, instead, a leaseholder wishes (or is required) to take a commonhold unit on conversion to commonhold, any mortgage secured on that lease could be automatically transferred to the commonhold unit. Alternatively, it would be necessary to seek the consent of the mortgage lender. In practice, the second option would mean that if leaseholders are able to retain their leases following conversion to commonhold (Option 1 presented above), only those who wish to take a commonhold unit will be required to seek the consent of their lenders. However, if, on conversion to commonhold, all leaseholders should be required to take a commonhold unit (Option 2), all lenders who have an
interest secured on any of the leases would be required to consent, which may make Option 2 unworkable where there are non-consenting leaseholders.

3.181 We now ask consultees, in light of the above proposals, and considering all the advantages and disadvantages, whether they prefer conversion Option 1 or Option 2. Should consultees have any suggestions of alternative options for conversion (which strike the necessary balance between the interests of those wishing to convert and minority protection, and provide a realistic mechanism for financing the freehold purchase) we would be pleased to take these suggestions into account.

### Consultation Question 10.

3.182 We have set out two options for setting the threshold of leaseholder support which should be required to convert to commonhold. The first would be to require leaseholders (who are qualifying tenants under enfranchisement legislation) owning at least 50% of the flats in the building to consent, provided non-consenting leaseholders are able to retain their leasehold interest on conversion to commonhold (Option 1). The second would be to require leaseholders (who are qualifying tenants under enfranchisement legislation) owning at least 80% of the flats in the building to consent, on the basis that non-consenting leaseholders are required to take a commonhold unit on conversion (Option 2).

3.183 We invite consultees’ views as to whether they prefer Option 1 or Option 2.

3.184 We invite consultees’ views as to any other options for setting the threshold of leaseholder support for conversion, other than Options 1 and 2, which strike an appropriate balance between the interests of those wishing to convert and non-consenting leaseholders, and provide a mechanism for financing the freehold purchase.
Chapter 4: What is the procedure for converting to commonhold?

4.1 In the previous chapter, we considered the conditions that must be satisfied in order to convert from leasehold to commonhold and, in particular, whose consent must be obtained. We now look at the steps that must be taken to convert a building to commonhold, once the necessary conditions have been satisfied.

4.2 Stakeholders have advised us that, for conversion to succeed, there ought to be a straightforward and cost-effective procedure for conversion. Whilst consultees have not raised specific issues with the process of converting (other than the consent requirement)\textsuperscript{105} we agree that, for existing leaseholders to be able to benefit from conversion, the procedure should be as cheap and as simple as possible.

4.3 In this chapter, we provide a general overview of the procedure for converting to commonhold. We then apply the conversion procedure to two specific scenarios. First, where the freehold of the building is owned by an external landlord and the leaseholders need collectively to acquire the freehold in order to convert. Second, where the freehold of the building is already owned by the leaseholders collectively. Whilst considering these scenarios, we make proposals which are aimed at making the conversion process more efficient. We then ask consultees whether the conversion procedure operates satisfactorily in both scenarios or whether further reform is needed to simplify the procedure and make it more cost-effective.

THE CURRENT LAW

4.4 A building can be converted to commonhold by applying to HM Land Registry to register the land as commonhold “with unit holders”.\textsuperscript{106} Currently, the application can only be made by the freehold owner of the land.

4.5 The person applying to register the land as commonhold (referred to as “the applicant”) must submit the following documents.

(1) A statement that the applicant is registering “with unit holders”.\textsuperscript{107} This statement must be in prescribed form COV\textsuperscript{108} and must contain a list of individuals who will

\begin{footnotesize}
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\item[105] Respondents to our Call for Evidence referred to uncertainty caused by the automatic termination of interests on conversion; see Commonhold: A Call for Evidence – Analysis of Responses, paras 2.9 to 2.17. We consider the extent to which interests may terminate, or continue automatically on conversion, in ch 3.
\item[106] The application to register the commonhold must be made on form CM1. For an explanation of registration “with unit holders” see ch 2, paras 2.5 to 2.6. The correct procedure for registering a new commonhold development is instead registration “without unit holders”. This procedure is considered in ch 6. See generally HM Land Registry, Practice guide 60: commonhold (July 2018), https://www.gov.uk/government/publications/commonhold/practice-guide-60-commonhold.
\item[107] CLRA 2002, s 9(1)(b). We refer to “unit holders” as unit owners in this Consultation Paper.
\item[108] Commonhold (Land Registration) Rules, r 5(2). It must be lodged with form CM1.
\end{enumerate}
\end{footnotesize}
take a commonhold unit on conversion to commonhold. For example, it may contain a list of leaseholders who will take commonhold units of their flats on conversion. The statement must also include prescribed information about the individuals who will become unit owners (such as the leaseholders’ addresses).\(^{109}\)

(2) A commonhold community statement ("CCS"). The CCS sets out the rights and obligations of the new unit owners and defines the boundaries between the units and common parts.

(3) A detailed plan. The CCS should be accompanied by a plan of the land to become commonhold which must be clear and accurate, otherwise HM Land Registry may reject the application.\(^{110}\) HM Land Registry provides an optional, free service to approve the CCS plan before it is submitted for registration.

(4) The certificate of incorporation of the commonhold association (which demonstrates that the commonhold association has been set up as a company) and its articles of association ("the Articles").\(^{111}\)

(5) A certificate given by the directors of the commonhold association that the Articles and CCS comply with the 2002 Act and the Commonhold Regulations 2004 ("the Commonhold Regulations").\(^{112}\)

(6) Evidence that the necessary consents have been obtained in prescribed form CON1.\(^{113}\) The applicant (which, currently, can only be the freeholder) must also provide a statement of truth confirming that the necessary consents have been obtained. This statement is conclusive proof to HM Land Registry that no further consents are required.\(^{114}\) If consent is given subject to conditions (see paragraph 3.6 in Chapter 3 above), the statement of truth provided to HM Land Registry must confirm that the necessary conditions have been fulfilled at the time of the application.\(^{115}\)

**What happens on conversion?**

4.6 Once the necessary information has been provided to HM Land Registry, the Registrar will register the land as an estate in commonhold land. At the same time:

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\(^{109}\) CLRA 2002, s 9(2). The information to be provided is prescribed by Commonhold Regulations 2004, reg 6.

\(^{110}\) Commonhold (Land Registration) Rules 2004, r 8.

\(^{111}\) CLRA 2002, sch 1 paras 2 to 4. On conversion to commonhold, the commonhold association will own and manage the common parts of the commonhold.

\(^{112}\) CLRA 2002, sch 1 para 7. The certificate must also confirm that the association has not traded and has not incurred any liability which has not been discharged.

\(^{113}\) Commonhold (Land Registration) Rules 2004, r 7.

\(^{114}\) Commonhold (Land Registration) Rules 2004, r 6(6).

\(^{115}\) Commonhold (Land Registration) Rules 2004, r 6(4)(c). Such a confirmation will be difficult to provide where a lender has given consent subject to the condition that it will be regranted new security over the commonhold unit after conversion, on which see further below at para 4.47.
the individuals named as the new unit owners in form COV provided to HM Land Registry will be registered as the freehold owners of their particular unit or units under separate title numbers;\textsuperscript{116}

(2) the commonhold association will be registered as the freehold owner of the common parts of the commonhold with a separate title number;\textsuperscript{117}

(3) the rights and duties which bind the unit owners and the commonhold association, set out in the CCS, will come into force;\textsuperscript{118}

(4) any leases and tenancies, of any term, whether over the whole or part of the commonhold land, will be extinguished;\textsuperscript{119}

(5) any charge over the whole or part of the common parts will be extinguished;\textsuperscript{120} and

(6) any charge over part only of a commonhold unit will be extinguished.\textsuperscript{121}

**CRITICISMS OF THE CURRENT LAW**

4.7 Several consultees responding to our Call for Evidence referred to the conversion process as being inadequate, over and above any difficulties caused by the consent requirement.\textsuperscript{122} Consultees called for a simple and cheap procedure for conversion that is led by leaseholders and which is free of anomalies. Consultees also argued that protections should be in place against freeholders tactically preventing or delaying conversion or injecting high fees into the process.\textsuperscript{123}

4.8 Other consultees and academics referred to specific practical difficulties arising from the automatic termination of all leases, tenancies and charges on conversion. These concerns are addressed to a large extent by our proposals in the previous chapter.

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\textsuperscript{116} CLRA 2002, s 9(3)(b) to (d).

\textsuperscript{117} CLRA 2002, s 9(3)(a).

\textsuperscript{118} CLRA 2002, s 9(3)(e).

\textsuperscript{119} CLRA 2002, ss 9(3)(f) and (4). This applies to leases granted before the commonhold association became entitled to be registered as the owner of the common parts.

\textsuperscript{120} To the extent that it relates to the common parts: CLRA 2002, s 8(3).

\textsuperscript{121} CLRA 2002, ss 22(3) and (4). Any charges over a lease (whether over the whole or part) will be extinguished as a result of the leases being extinguished on conversion. If there is a charge over the whole of a freehold unit, for instance a house on an estate which is to become commonhold, it appears this charge may subsist following conversion, however any charge over part of this freehold unit would be extinguished on conversion.

\textsuperscript{122} In particular, John Cooney (member of the public) referred to the conversion process as being “longwinded and expensive” and the Commercial Real Estate Legal Association (a body representing the views and interests of non-contentious real estate lawyers) argued that the process “is likely to be too complex”. See Commonhold: A Call for Evidence – Analysis of Responses, paras 2.2 to 2.8.

\textsuperscript{123} See Commonhold: A Call for Evidence – Analysis of Responses, para 2.4.
particular, we propose that tenancies of 21 years or less should automatically continue on conversion to commonhold.\textsuperscript{124}

4.9 We agree that for conversion to commonhold to succeed, the conversion procedure should be as straightforward and as cost-effective as possible.

4.10 Our discussion of the conversion procedure distinguishes between two scenarios.

(1) Where leaseholders do not already own the freehold collectively and need to acquire the freehold from an external landlord in order to convert to commonhold.

(2) Where the freehold of the building is already owned by the leaseholders collectively.

WHERE LEASEHOLDERS NEED TO ACQUIRE THE FREEHOLD COLLECTIVELY IN ORDER TO CONVERT

4.11 As explained in Chapter 2, in order to convert to commonhold, leaseholders will need to acquire the freehold of their building. On conversion, the freehold of the units (such as flats within a block of flats) will be transferred to the unit owners (the former leaseholders in the block) and the freehold of the common parts will be transferred to the commonhold association (of which the unit owners will be members). If the freeholder does not agree to sell the freehold voluntarily, it will be necessary for the leaseholders to purchase the freehold compulsorily. Collective enfranchisement, as provided for under the Leasehold Reform Housing and Urban Development Act 1993 (the “1993 Act”), already sets out a procedure for doing so.

4.12 We consider it undesirable at this stage to create a different procedure for purchasing the freehold as part of the conversion process. The 1993 Act already provides a framework under which leaseholders can exercise their right to purchase the freehold and agree the terms of the purchase. Creating a separate but slightly different procedure to achieve the same result for conversion would seem to add an unnecessary layer of complexity to our reforms.

4.13 The outcome is that, to convert, leaseholders will need to follow the collective enfranchisement process and any additional processes for conversion to commonhold. Whilst at first glance this may seem to create a long-winded procedure for conversion, we consider that, in practice, any difficulties will be mitigated in the following ways.

(1) The procedure for collective enfranchisement is currently under review by the Law Commission and is considered in our Enfranchisement Consultation Paper.\textsuperscript{125} In that paper, we suggest a number of revisions to the existing collective

\textsuperscript{124} See ch 3 paras 3.148 to 3.1152. Residential leases of over 21 years may or may not be extinguished, depending on consultees’ responses to the questions raised in ch 3. In particular, Consultation Question 10 asks whether leaseholders, who do not want to convert to commonhold, should be able to retain their leases on conversion to commonhold. The effect of conversion on charges is discussed in ch 3, paras 3.153 to 3.172. Charges granted over leases which may continue on conversion should not expire on conversion to commonhold.

\textsuperscript{125} Enfranchisement Consultation Paper, ch 11. The paper refers to the revised collective enfranchisement process as “collective freehold acquisition”.

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enfranchisement procedure aimed at making the procedure easier, quicker and more cost-effective. These reforms will have the added benefit of making it simpler, quicker and cheaper for leaseholders who do not own the freehold to convert to commonhold.

(2) In practice it would be possible to streamline the processes of enfranchising and converting to commonhold. Streamlining these processes would have the advantage of saving costs, saving time and reducing the anomalies which may otherwise arise if leaseholders first enfranchise and later convert to commonhold.

4.14 In this section, we set out how leaseholders could “enfranchise and convert” in a streamlined way, incorporating both the processes for collective enfranchisement and conversion. We provide a summary of the proposals for reforming the enfranchisement procedure made in our separate project, before considering how conversion would work, incorporating these processes for collective enfranchisement.

4.15 The purpose of setting out this streamlined procedure is illustrative rather than prescriptive. In other words, we seek to demonstrate how leaseholders, who want to convert to commonhold, could do so in the most efficient manner. We also set out some provisional proposals which would make the streamlined procedure operate more successfully. We ask consultees whether the streamlined process would alleviate stakeholder’s concerns about the conversion process or whether more extensive reforms are required.

4.16 We consider that the streamlined procedure should, at this stage, remain optional. Leaseholders could still decide to convert to commonhold using a distinct two-stage procedure by collectively enfranchising (in order to buy the freehold) and then converting to commonhold (to put in place the commonhold management structure) at a later point. It may be that, after starting the enfranchise and convert process or after having acquired the freehold, the leaseholders no longer want to convert to commonhold. There would be nothing in the legislation or under our proposals for reform which would force the leaseholders to convert to commonhold in this scenario.

4.17 Leaseholders’ ability to change their minds may, however, be restricted by the terms of any contractual agreement entered into before commencing a claim to enfranchise and convert. For example, leaseholders may sign an agreement setting out who will support the claim and contribute towards the purchase price. The terms of this agreement may

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127 For example, it would not be advisable, during the enfranchisement process, to grant new leases to individuals who would be required to take a commonhold unit on conversion.

128 In ch 3 we explained that, in the future, it may be possible and desirable to create a bespoke conversion procedure, independent of collective enfranchisement with different qualifying criteria and processes. We explained that if such a procedure were introduced, it would not be possible for leaseholders to change their minds about converting to commonhold after having commenced a claim. Nor should it be possible for such leaseholders to revert back to leasehold after having acquired the freehold. At this point in time, we consider it appropriate to provide leaseholders with as much choice and flexibility as possible as regards to the structure they put in place after having acquired the freehold.
also dictate when and in what circumstances it will be possible to withdraw the claim. Such agreements are already commonplace in collective enfranchisement claims.

Consultation Question 11.

4.18 We provisionally propose that, where the freeholder refuses to consent to conversion, the leaseholders will need to follow the collective enfranchisement process to purchase the freehold in order to convert to commonhold.

Do consultees agree?

4.19 Before considering how a streamlined procedure might operate, we first explain the processes involved in purchasing the freehold collectively as provisionally proposed in our separate leasehold enfranchisement project. The processes do not necessarily reflect the position under the current law.

**Our proposed collective enfranchisement procedure**

4.20 To compulsorily acquire the freehold, the leaseholders would need to take the following steps.

**Claim Notice**

4.21 The leaseholders must notify the freeholder of their claim by serving a formal notice on the freeholder ("a Claim Notice"). We provisionally propose that the Claim Notice should be a prescribed document available online. The notice should include the following information:

1. the names of each of the leaseholders who are bringing the claim and their signatures (although we have asked consultees whether the requirement for a signature should be maintained);  
2. in respect of each named leaseholder:
   a. the address of his or her leasehold premises; and
   b. prescribed details of his or her lease.
3. the number of residential units in the building and the number of leaseholders eligible to participate in the claim. The leaseholders must also complete a number of tick boxes confirming that the necessary qualifying criteria have been satisfied;

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129 Our provisional proposals for reform are set out in full in Enfranchisement Consultation Paper, ch 11. We refer to this process in our Enfranchisement Consultation Paper as "collective freehold acquisition".

130 Before serving the Claim Notice, the leaseholders may serve an "Information Notice" the freeholder if they need more information in order to identify the person on whom a Claim Notice should be served.

(4) the name and address of the person nominated by the leaseholders to acquire the freehold from the freeholder (this person may be an individual – or individuals, or a company and is referred to as “the nominee purchaser”);  

(5) the name of the freeholder on whom the notice is to be served, if known;  

(6) the address of the premises owned by the freeholder which the leaseholders seek to acquire;  

(7) a plan showing the location of the premises which the leaseholders are seeking to purchase and a plan showing the extent of the property claimed;  

(8) the terms on which the leaseholders propose to purchase the freehold including the purchase price;  

(9) an address at which any Response Notice (see below) must be served by the freeholder;  

(10) the date by which any Response Notice must be served by the freeholder;  

(11) the addresses at which the Claim Notice is to be served, together with the category of prescribed address into which those addresses are considered to fall;  

(12) confirmation that the leaseholders have carried out certain specified checks (for instance that the leaseholders have checked the freeholder’s address for service) prior to completing the notice.

Response Notice

4.22 The Response Notice should be served by the date specified in the Claim Notice, which must be at least six weeks after service of the Claim Notice. Again, it is proposed that the Response Notice will be a prescribed document available online. The freeholder will, amongst other details, set out whether he or she admits or denies the leaseholders’ collective claim as set out in the Claim Notice. The Response Notice will need to be accompanied by a draft contract or transfer which sets out the terms on which the freeholder would be willing to sell the freehold.

Settling terms

4.23 The leaseholders may apply to the First-tier Tribunal (Property Chamber) for England or the Residential Property Tribunal for Wales (“the Tribunal”) if the freeholder fails to serve a Response Notice after six weeks (or, if later, the date set out in the Claim Notice). If the freeholder does serve a Response Notice, but matters remain in dispute after 21 days, the leaseholders or the freeholder may apply to the Tribunal to progress the claim.

See Enfranchisement Consultation Paper, paras 11.61 to 11.73.
Withdrawing claims

4.24 Leaseholders will be able to withdraw their enfranchisement claim collectively at any stage prior to the freehold being transferred by serving a written notice of withdrawal on the freeholder. There may, however, be cost consequences of doing so.\(^\text{133}\)

Contract and transfer

4.25 Once all matters have been agreed or resolved, a binding contract can be entered into for the purchase of the freehold and any leasehold interest which is superior to that of any qualifying tenant. A qualifying tenant is generally a residential leaseholder who has been granted a lease of over 21 years – see paragraph 3.45 above. The contract will be entered into between the nominee purchaser and the freeholder.

4.26 A transfer deed will be executed and registered at HM Land Registry,\(^\text{134}\) which will transfer legal title to the property to the nominee purchaser.

4.27 Additionally, whilst not regulated by statute, it is common practice for leaseholders to enter into a “participation agreement” before commencing a collective enfranchisement claim. This agreement will set out how the purchase of the freehold will be financed and what will happen following acquisition. Frequently, it will be decided that those financing the purchase will be granted longer leases at no ground rent (or a “peppercorn” rent) after acquisition. Additionally, leaseholders may agree the circumstances in which their Claim Notice will be collectively withdrawn.

4.28 We now explain how we envisage the enfranchisement processes set out above could be incorporated into a streamlined enfranchise and convert procedure. We also make certain proposals to reform the current law of commonhold to better facilitate the streamlined process.

Streamlined “enfranchise and convert” procedure

Initial preparations

4.29 Before commencing a claim to enfranchise and convert, leaseholders could take the following initial organisational steps. They could:

(1) obtain the necessary leaseholder consents and decide who will be taking a commonhold unit on conversion;

(2) decide how the purchase of the freehold will be financed;

(3) decide the circumstances in which the Claim Notice will be withdrawn (on which see further below);

(4) register the commonhold association at Companies House; and

(5) prepare the CCS or decide how and when the CCS will be prepared. Leaseholders may decide to delay preparing this document to avoid wasting time and costs should the enfranchisement claim fail for any reason.

\(^{133}\) Enfranchisement Consultation Paper, paras 13.92 to 13.95.

\(^{134}\) HM Land Registry form TR1 (where the transfer is of the whole of the freeholder’s property).
4.30 We have considered whether it might be possible for statute to create an entirely “default” CCS which would apply in the event of the leaseholders failing to lodge a CCS at the point of registration. Whilst the model CCS provides standardised rules which apply in every commonhold, there will always be a need for rules which are specific to the individual commonhold. In particular, the leaseholders will need to fill in the Annexes to the CCS by providing information specific to the commonhold, such as the number of votes allocated to each owner and the share of commonhold contributions to be paid by each owner.  

4.31 We do not, however, consider that an entirely “default” CCS is either practical or desirable. Such rules could not take into account the particular features of the development and could lead to undesirable results. Nor would it be possible to create a “default” plan of the development which must accompany the CCS.

4.32 In any event, it is likely that leaseholders will wish to appoint an expert to ensure that the allocation of votes, shares of the commonhold contributions to be paid by each owner, and the boundary divisions are appropriate. This expert could use the provisions of the leases as a starting point, but would be able to identify any particular features of the development which require tailoring in the CCS.

4.33 If leaseholders do not wish to prepare the CCS at the outset of the claim, they could instead agree to refer the preparation of the CCS to a named expert, or decide that they will prepare the CCS between themselves but refer any disputes to an expert.

Claim Notice

4.34 The leaseholders may then commence their claim to enfranchise and convert by serving a Claim Notice. Under our provisional proposals for enfranchisement reform, the Claim Form would be a prescribed document available online. The leaseholders would name the commonhold association as the “nominee purchaser” who will acquire the freehold from the freeholder.

4.35 The names of the leaseholders who are bringing the claim to enfranchise and convert must be provided on the Claim Notice. In the previous chapter, we explained that, to assist with a streamlined enfranchise and convert process, the same individuals who are eligible to participate in a collective enfranchisement claim should also be eligible to participate in a decision to convert. In practice, therefore, the same individuals would agree to the enfranchisement and conversion to commonhold.

4.36 We think that, to avoid duplication, the Claim Notice could stand as evidence that the necessary consents for both enfranchisement and conversion have been obtained. It would therefore not be necessary for leaseholders to produce a separate list of consents on form CON1.

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135 Rules specific to the particular commonhold are called “local rules”. See ch 8, and in particular para 8.7.

136 For example, ownership of balconies.

137 And potentially also their signature, subject to the outcome of our enfranchisement consultation.

138 Although, if conversion under Option 2 is pursued and the decision to convert is not unanimous, the Tribunal’s order could instead act as sufficient proof that the necessary consents have been obtained (see further n 39).
4.37 If the Claim Notice is to stand as proof that the necessary consents have been obtained, there are two consequences.

4.38 First, the prescribed Claim Notice could state that the leaseholders named in the notice wish to enfranchise collectively and convert to commonhold. However, it should be clear that if, for any reason, conversion does not take place, the leaseholders still support the collective acquisition of the building. Leaseholders would therefore be able to decide at a later stage to only enfranchise and not convert to commonhold. It might be possible for the Claim Notice also to stand in the place of form COV which lists the leaseholders who will take a commonhold unit on conversion, perhaps through an additional tick box.

4.39 Second, in order for the Claim Notice to stand as evidence that the consents for both enfranchisement and conversion have been obtained, it would be necessary to create consistency between the circumstances in which consent may be withdrawn. Currently, once a leaseholder has agreed to a collective enfranchisement claim and his or her name has been provided on the Claim Notice, that individual leaseholder will not be able to withdraw consent to the enfranchisement. The Claim Notice can only be withdrawn by the leaseholders acting collectively. The enfranchisement legislation does not set out a minimum number of leaseholders who must agree to the withdrawal. Rather, the decision to withdraw the claim is left as a matter of negotiation between the leaseholders.

4.40 Conversely, under the commonhold legislation, leaseholders may be able to withdraw their individual consent to the conversion. Additionally, leaseholders’ consent to conversion will automatically be withdrawn after 12 months. Some enfranchisement claims may take longer than 12 months to pursue. Leaseholders may therefore bring a claim to enfranchise and convert and, at the point of creating the commonhold, find that the necessary consents have lapsed or have been withdrawn and it will be necessary to obtain consents for a second time. Moreover, withdrawal of consent (or a lapsed consent that cannot be renewed) may mean that the threshold for conversion (qualifying leaseholders of either 50% or 80% of the flats in the building) is no longer met and so conversion would be blocked.

4.41 To align the two procedures, it would be possible to prevent consents to conversion lapsing after 12 months and prevent leaseholders withdrawing their individual consent to conversion. Instead, the leaseholders could decide collectively not to pursue the conversion. It would not be necessary to notify the landlord of this decision or take any specific procedural steps. The circumstances in which the leaseholders may reach such a decision could be set out in a participation agreement before making the claim. Whilst

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139 As will be explained further below, if leaseholders no longer wish to pursue conversion, they would have the option of changing the nominee purchaser at a later stage (for example, to a company other than a commonhold association).

140 A Radevsky and D Greenish, Hague on Leasehold Enfranchisement (6th ed 2014) para 28-02. As explained above, the leaseholders may enter into a contractual agreement before bringing the claim which sets out the circumstances in which the claim may be withdrawn.

141 Commonhold Regulations 2004, reg 4. There is no prescribed way of withdrawing consent. There is therefore ambiguity surrounding when consent will be considered withdrawn, for example, it is unclear whether an oral statement by a leaseholder withdrawing consent would be sufficient.

142 See ch 3 para 3.145.
preventing consents from lapsing does not, in our opinion, create particular concerns, we would be grateful for consultees’ views on whether leaseholders should be able to withdraw their individual consent to the conversion.

4.42 We note, in this context, that a decision to sign a Claim Notice, will not, as a matter of law, commit a leaseholder to paying for a share of the freehold at the point of transfer. Not all of those who consent will necessarily fund the conversion. If one leaseholder supports conversion but cannot contribute towards the finance, the other leaseholders would need to find another way to finance the purchase. However, refusing to contribute towards the purchase price may constitute a breach of any participation agreement entered into before bringing the claim.

**Consultation Question 12.**

4.43 We provisionally propose that, to simplify the procedure for converting to commonhold, any consents given in support of the conversion should not automatically lapse after 12 months.

Do consultees agree?

4.44 We invite consultees’ views as to whether leaseholders should be able to withdraw their individual consent to conversion after the Claim Notice has been served, or whether leaseholders should be required to make a collective decision no longer to proceed with the conversion.

**Response Notice**

4.45 The freeholder will only be able to reject the leaseholders’ claim if the collective enfranchisement qualifying criteria have not been satisfied. We want to ensure that the freeholder will not be provided with any new ground to oppose the compulsory acquisition of his or her property. The freeholder would not be required to check whether any additional criteria for conversion have been satisfied. As we explain further below, those applying to convert to commonhold will only need to satisfy HM Land Registry (through the provision of certain documents) that the necessary consents for conversion have been obtained at the point of registering the commonhold. The freeholder would not have any power to prevent the enfranchisement claim from proceeding if the qualifying criteria for enfranchisement have been satisfied.

**Transfer and conversion to commonhold**

4.46 We agree with consultees that conversion should be a procedure which is capable of being led by leaseholders. It is the leaseholders who are driving the conversion, and in whose interests conversion is taking place. Once the transfer of the freehold is in progress on a collective enfranchisement, we see no reason why the leaseholders should not be able to make the application for conversion, even though title to the freehold remains registered with the freeholder. Therefore, we provisionally propose that leaseholders (in addition to the freeholder) should be able to apply to HM Land Registry to convert the building to commonhold. Those applying to create the commonhold at HM Land Registry would need to lodge:
(1) a transfer deed, transferring the freeholder’s land to the commonhold association;

(2) the CCS and plan;

(3) evidence of consents. This could simply be the Claim Notice (if this is to stand in place of form CON1 (evidence of consents), and form COV (list of individuals taking a commonhold unit (see paragraphs 4.45(1) and (6) above)). We make a provisional proposal below which addresses a particular complication where consent has been given subject to conditions;

(4) the commonhold association’s certificate of incorporation and Articles; and

(5) a certificate by the directors of the association that the CCS and Articles comply with the 2002 Act and Commonhold Regulations.

4.47 Currently, as explained in paragraph 4.5(6) above, where consent has been given subject to conditions (in order words, consent will only be given on the occurrence of a particular action or circumstance), the statement of truth provided to HM Land Registry must confirm that the necessary conditions have been fulfilled at the time of the application. This creates a particular difficulty where mortgage lender consent is required. A lender may only provide consent on the condition that it will be regranted new security over the commonhold unit after conversion. It will be impossible to confirm, at the time of application, that such a lender has been granted new security over a commonhold unit. To address this difficulty, we suggest that deeds of substituted security (which will transfer lenders’ security from the lease to new commonhold units after conversion) will act as satisfactory evidence that the condition has been fulfilled.

4.48 On receipt of the documents listed at paragraph 4.46 above, HM Land Registry should register the land as an estate in commonhold land. The common parts of the commonhold will be registered in the name of the commonhold association, and the leaseholders named as taking a commonhold unit will be registered as individual freehold owners of their flats.

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143 If conversion Option 2 (see ch 3 paras 3.105 to 3.144, and in particular paras 3.138 to 3.141) is pursued and all leaseholders will be required to take a commonhold unit on conversion, a copy of the Tribunal’s order may instead be provided. In the previous chapter, we proposed that such an order would be necessary where the decision to convert under Option 2 is not unanimous. The Tribunal’s order would confirm that the necessary consents have been obtained and that the terms of the CCS sufficiently protect the interests of non-consenting leaseholders.

144 Commonhold (Land Registration) Rules 2004, r 6(4)(c).

145 We discuss the issue of lender consent in more detail in ch 3, paras 3.153 to 3.172. We invite views on whether it may be possible for a charge to transfer automatically from a lease to a commonhold unit without lender consent.

146 See para 4.8 and n 20 above for summary of whether tenancies and leases will continue or terminate on conversion to commonhold.
Consultation Question 13.

4.49 We provisionally propose that (in addition to the freeholder) it should be possible for leaseholders who are in the process of acquiring the freehold by collective enfranchisement, to apply to HM Land Registry to create a new commonhold.

Do consultees agree?

4.50 We provisionally propose that, where a lender has consented to a conversion to commonhold on the condition that it will be granted new security over the commonhold unit after conversion, a deed of substituted security provided to HM Land Registry will act as sufficient evidence that this condition has been fulfilled.

Do consultees agree?

4.51 We now move on to consider the procedure for converting to commonhold where the leaseholders already own the freehold collectively.

WHERE THE FREEHOLD IS ALREADY OWNED BY THE LEASEHOLDERS COLLECTIVELY

4.52 Many leaseholders may already own the freehold of their building collectively, for example, if they have already exercised the right to collective enfranchisement. The position following collective enfranchisement (or where the leaseholders otherwise own the freehold) is however different from that following conversion to commonhold. In Chapter 2, we set out the key differences between collective enfranchisement and conversion and provide a table illustrating the differences at paragraph 2.33. We also explain why leaseholders who have already collectively enfranchised, may wish to covert to commonhold in Chapter 1.

4.53 Leaseholders who own the freehold collectively would need to:

1. create a new company to act as the commonhold association which will own and manage the common parts after conversion;

2. agree the terms of a CCS with accompanying plan; and

3. provide evidence that the necessary consents have been obtained and confirm who will take a commonhold unit on conversion.

4.54 It may seem surprising that a new company must be set up as the commonhold association even where the freehold is already held by a company (T Co, in our example throughout this Part). However, we think that it is likely to be necessary to create a new company for three reasons.

4.55 First, we understand that, currently, the majority of companies in which the freehold is owned collectively by the leaseholders (known as freehold management companies or

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147 See ch 2, n 16 above.
“FMCs”) are set up as companies limited by shares. A commonhold association must be a company limited by guarantee, and it is not possible, as a matter of company law, for a company limited by shares to become a company limited by guarantee.

4.56 Second, even in the minority of cases where the FMC is a company limited by guarantee, the company would need to change its articles to become the commonhold association. It would need to time the change so that the FMC becomes the commonhold association at the same time the land is registered as commonhold at HM Registry. However it would be very difficult (if not impossible) to do so. The FMC would need to change its name at Companies House and obtain a certificate of its name change, prior to lodging an application to register the commonhold at HM Land Registry.

4.57 Third, unless the same leaseholders who own a share of the freehold also want to take a commonhold unit on conversion, there will need to be a procedure (effectively a second enfranchisement) whereby those leaseholders who do not yet own a share of the freehold pay those who originally contributed towards the purchase price. This process could be achieved through the terms of the sale of the property from the FMC to the new commonhold association.

4.58 We therefore provisionally propose that where the freehold of the building is owned by a FMC, the freehold should be transferred to a commonhold association as part of the conversion process. The transfer to the commonhold association should be registered at the same time HM Land Registry registers the land as commonhold.

Consultation Question 14.

4.59 Where the freehold of the building is owned by the leaseholders collectively through a freehold management company (a “FMC”), we provisionally propose that the common parts of the building should be transferred to a new commonhold association as part of the process of conversion to commonhold (rather than the FMC changing its articles to become a commonhold association, where this is possible).

Do consultees agree?

HM Land Registry will not register the land as commonhold unless a commonhold association has already been set up (see para 4.5(4) above). This would mean that a FMC would need to amend its articles to become a commonhold association before the application to HM Land Registry is made. However, if there is a gap between the FMC becoming a commonhold association and the registration of the commonhold land, the directors of the FMC would be placed in a difficult position. The directors would not be able to carry out the functions of a commonhold association in respect of commonhold land, if the land has not yet been registered as commonhold. Further, it would not be possible for the directors to carry out any other function. The directors of a company have a duty to act within their powers (see Companies Act 2006, s 171). If the directors enter into contracts outside of their powers, they can become personally liable to refund the sums spent on the contract (see Re Lands Allotment Co [1894] 1 Ch 616). It would also be possible for any member of the company to seek an injunction against the directors preventing them from entering into a contract outside of their powers (Simpson v Westminster Palace Hotel Co (1860) 8 HL Cas 712) or, in limited circumstances, to apply for the transaction to be set aside.
SUMMARY AND CONCLUSION

4.60 In this chapter, we have explained how a streamlined conversion procedure could operate, incorporating the processes for collective enfranchisement and conversion. We also set out some provisional proposals for amending the current law of commonhold to better facilitate this streamlined procedure. Taking into account our explanation of the streamlined procedure and our provisional proposals, we would be grateful for consultees’ views on whether any further reforms are necessary to make the conversion process as simple and as cost-effective as possible.

Consultation Question 15.

4.61 We invite consultees’ views as to whether, taking into account our provisional proposals set out in questions 11 to 14, the conversion procedure would operate satisfactorily.

4.62 We invite consultees’ view on what changes could be made to simplify the procedure and make it more cost-effective.
Part III: New commonhold developments
Chapter 5: Mixed-use and multi-block developments

INTRODUCTION

5.1 In our Call for Evidence, we explained that commonhold has been criticised for its one-size-fits-all approach, which makes it difficult to use for mixed-use or multi-block developments.

5.2 Whilst many new developments are exclusively residential, with a small number of very similar blocks of flats, there is an increasing nationwide trend for developers to build larger, more complex developments. These developments may contain a mixture of different uses, such as commercial elements alongside residential properties. A single development will now often combine:

1. multiple types of residential properties; for instance, a mix of modern blocks and converted listed buildings, or a mix of flats and terraced houses;
2. commercial properties such as shops, hotels and offices; and
3. a number of other facilities; for instance, leisure facilities, open spaces, and power plants.

5.3 Additionally, the properties within the development may be owned in a variety of ways. Residential properties may be owned on long leases, including those sold through shared ownership schemes, or rented by social tenants. Commercial properties may be sold to businesses, or rented on commercial leases. Two of the main forces behind the trend for more complex developments seem to be the increased need for city-centre living, and a desire to develop communities, not just residential estates.

5.4 Mixed-use and multi-block developments like these must be underpinned by a sophisticated legal framework. This framework needs to set out and regulate the interests of each different part and each different type of property owner. At the same time, it must also be able to regulate areas shared by the whole development. In particular, it needs to address how, and by whom, decisions can be made and who needs to contribute how much to any shared costs.

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1 Whilst this trend is perhaps particularly evident in London, more complex developments are being built in towns and cities across England and Wales. Some examples include: the Pumpfields and Lime Street developments in Liverpool; the NOMA and New Square developments in Manchester; the Kirkstall Forge development in Leeds; the Smith's Dock development in North Shields; the Arena Central and Exchange Square developments in Birmingham; the Westside development in Wolverhampton; the Central Quay and W2 developments in Cardiff; the Swansea Central development; the Campbell Park development in Milton Keynes; the Marketfield Way development in Redhill; the Panorama development in Ashford; and the Preston Barracks development in Brighton.

2 A long lease is a lease that is granted for a term of more than 21 years.

3 A shared ownership lease is a lease under which the leaseholder purchases an equity “share” of a house or flat (usually between 25 and 75%) and pays rent on the remainder of the property. The lease permits the leaseholder to acquire additional shares in the property over time, usually up to 100%. Shared ownership is discussed in more detail in ch 12.
5.5 Leasehold currently provides a legal structure which is able to accommodate such developments. The leasehold structure enables common areas to remain under the single management of one landlord, while different types of residential blocks and commercial premises can each have leases that are appropriate for the particular type of property. The ability to add bespoke provisions to each lease effectively enables each type of interest to be managed differently, according to its needs.

5.6 If commonhold is to be a viable alternative to leasehold beyond simple residential developments, it must be usable for mixed-use and multi-block developments. However, the current commonhold framework has been criticised for lacking the sophistication to do so. In this chapter we explain the problems with the current law and suggest reforms to make commonhold a more viable option for complex developments.

THE CURRENT LAW

5.7 The current commonhold model requires a whole building to be part of the same commonhold. Further, each commonhold can seemingly have only one commonhold association. As a result, all unit owners within a development must be members of a single commonhold. All management decisions affecting any part of the development will be taken by all the unit owners. Additionally, each unit owner will need to pay a fixed share of all the costs of the development.

5.8 A simplified example may be a useful aid to understanding the current law. This example will also be used in the discussion below to illustrate how each of the options for reform would operate in practice.

A hypothetical example

5.9 Figure 15 below depicts a development comprising two buildings. One is a tower block with three large, non-residential units on the first three floors and six modern flats over the top two floors (Building A). There is also a separate, listed building on the estate which has been converted into 12 residential units (Building B). There is a concierge service and a small gym inside Building B which can only be used by the residents of Building B. There is also a driveway and car park shared by the unit owners in both buildings.

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4 In this sense, a whole building is one which is vertically divided from other buildings. This would include, for instance, a building in a terrace which is completely vertically divided from its neighbours. There are specific exceptions to the requirement for a commonhold to include a whole building, which would allow either a basement or the upper floors of a building to be excluded from a commonhold, although these exceptions are unlikely to be used frequently: see CLRA 2002, sch 2 para 1.

5 CLRA 2002, s 2: the CLRA refers only to a single commonhold association. It does not explicitly preclude multiple commonhold associations operating in relation to the same area of land. However, it provides no indication that this was ever envisaged, and gives no guidance as to the relationship between multiple associations on the same land.
5.10 Under the current law, there are two possibilities for how the development above could be structured.

(1) The whole development could be treated as a single commonhold, with one commonhold association governed by the terms of a single commonhold community statement (“CCS”). The CCS would set out a fixed percentage that each unit owner would be required to pay towards all the shared costs of the commonhold, such as the upkeep of the driveway. For instance, each unit owner might be required to pay an equal share of the costs of the association (4.8% each).\(^6\) This option would mean that the owners in both Buildings A and B would

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\(^6\) In practice, the percentage contribution is likely to be different for different units, to reflect the fact they are different sizes.
have to pay towards the costs of maintaining the car park and shared driveway, but also towards the cost of providing the gym and concierge, which benefit only Building B.

The CCS would also set out the percentage of the votes allocated to each unit. As there is only one commonhold association, all the members would be entitled to vote in decisions relating to any part of the development. These voting rights would mean that, for instance, the unit owners in Building A could vote on decisions concerning the gym and concierge in Building B. As there would be more residential unit owners in the development, the residential unit owners could also outvote the commercial unit owners, even on issues which solely affect the commercial units, such as whether to install security systems to be used by the commercial units only.

(2) Alternatively, Building A and Building B could be created as two separate commonholds. Each commonhold would have its own commonhold association, which would be responsible for making any decisions relating to that building only, and would be responsible for any associated costs. The driveway and the car park would need to be owned by one of the commonhold associations; for example, Building A. There would then need to be some form of regulation of the relationship between the two commonholds, in relation to their use of the car park and driveway. There are two ways this could be done.

(a) Easements and licences could be used to create rights of access and permissions for the residents of Building B to use the driveway and the car park. However, it would be difficult to require future residents of Building B to pay for the upkeep of these areas, as obligations to pay money or perform an action in relation to a property (such as to repair a wall or a roof) cannot legally be passed to future owners of freehold property. In other areas of property law, workarounds have been found to try and pass on obligations to do something to future owners (such as deeds of covenant or estate rentcharges), but these workarounds are often unsatisfactory. To address this issue, the Law Commission has proposed the creation of a new interest in land (“the land obligation”) which could be positive or negative and would bind future owners of the land. However, the land obligation is not designed to meet the needs of freehold flats and other multi-occupancy developments. The land obligation, if introduced, could be used to allow binding obligations to repair property or pay money to be created between two commonholds. For instance, these methods could be used to require the residents in Building B to contribute to the costs of the car park. However, the obligation would only relate to the financial contributions, and could not be used to give the residents in Building B a vote in the decisions regarding the car park. Only the unit owners in Building A would be able to vote in decisions regarding the car park and driveway.

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7 See Making Land Work (2011) Law Com No 327, ch 2, for an explanation of estate rentcharges and deeds of covenant.

8 See Making Land Work (2011) Law Com No 327 paras 1.10, 5.17, 5.18, 5.90 and 5.91.
Alternatively, each commonhold could enter into a long-term management contract with an estate management company, so that a single company managed the entire estate. The contract would be set up by the developer for the provision of services common to all the buildings. The owners in both buildings would be responsible for contributing to the shared costs under the terms of the contract. However, under this approach, there would be potential for unit owners to be tied into long-term contracts over which they had little or no say. Consequently, management contracts established at the outset would work against one of the aims of commonhold: to give control to unit owners to make their own management decisions. This approach therefore risks reintroducing some of the problems that have arisen with residential leasehold ownership.

CRITICISMS OF THE CURRENT LAW

5.11 We have been told by respondents to the Call for Evidence that the current commonhold model does not offer a sufficient level of flexibility to cater for mixed-use or multi-block developments.

5.12 The example set out above suggests the problems are threefold.

(1) First, every development must have a single rulebook (the CCS). In essence, commonhold currently assumes that all of the unit owners have similar types of property and the same, shared interests. However, this assumption may not be true for larger or more complex developments. It has been suggested that a single CCS for each development cannot adequately cater for the different interests and needs of different types of unit owner.

There are concerns, for example, that residential owners’ interests will be significantly different from those of commercial owners. Commercial owners may be reluctant to invest in commonhold premises if they feel that their interests may be outweighed by a majority of residential owners (and vice versa). It has therefore been suggested that it should be possible to separate out the management of these different elements. The second option discussed above, of creating separate commonholds, would enable this separation of management if the commercial units were in a separate building. However, mixed-use developments will often have a combination of commercial and residential units in the same building (as is illustrated in the example in figure 15). The current law provides no mechanism at all for separating out the management of different types of unit within the same building.

(2) Secondly there is no effective way to manage the relationship between two or more commonholds where there are shared facilities; for instance, the driveway and car park in the example in figure 15 above.

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9 Although, see ch 9 where we make provisional proposals to allow commonhold associations the option to end a long-term contract, without penalty, within a set period of, for instance, six months from the date when the association came fully under the effective control of its members.

10 See further ch 1 where we set out some of the issues which have arisen in leasehold.

11 See the Commonhold: A Call for Evidence – Analysis of Responses, question 5.
As discussed in paragraph 5.10(2) above, solutions could potentially be found to create the necessary financial obligations. However, these solutions do not create voting rights to accompany the financial responsibility. For example, owners in Building B could be required to pay towards the costs of maintaining the driveway and car park. However, the owners in Building B would not have the right to vote on any related decisions. This situation would require the owners in Building B to pay towards decisions they were unable to influence. For instance, the owners in Building A could decide that they want to replace the gravel driveway with a tarmac one. The owners in Building B could find themselves liable to contribute towards the cost of doing so, despite having had no say in the decision.

The lack of a standardised, workable framework to regulate relationships between commonholds may open the way for overly complex and diverse drafting, as developers try to create solutions. Such drafting would likely lead to a reduction in consumers’ awareness of what they own, and could have other undesirable consequences. It also negates the potential benefit of standardisation that commonhold can offer.

Thirdly, there is a lack of flexibility in how costs may be allocated. The percentage contribution each owner is required to pay towards the cost of running the commonhold is fixed in the CCS. All shared costs must be paid by all unit owners in the fixed percentages set out by the CCS. There is no flexibility to allow different percentage contributions to apply to different categories of cost. For example, under the first option discussed above at paragraph 5.10(1), owners in Building A would have to pay towards the cost of providing the gym and concierge service, which only the owners in Building B are entitled to use. As another example, if it was felt that the owners of the listed apartments should pay more because of the increased costs of maintaining listed Building B, then they would have to pay more for everything. It would not possible to set up a commonhold so that the owners of the listed apartments pay for the upkeep of their block, and the owners of the modern apartments pay for the upkeep of theirs, but both pay equally towards the maintenance of a car park or some other shared facility.

5.13 It is clear to us that commonhold needs to be made more flexible, in order to be workable for all types of development. Achieving this result is likely to require commonhold’s management framework to be made more sophisticated, so that the problems outlined above can be resolved. Before setting out the options for reform, we first set out the objectives we think any new management framework must meet.

Objectives for a reformed management framework

5.14 We think the management framework for commonhold needs to achieve the following objectives.

(1) The framework should provide the ability to separate out the management of a variety of different types of interest within the same development, in particular by:

(a) differentiating voting rights, so that those affected by a decision are entitled to participate (either through voting, or by electing the responsible directors) in making that decision, and no one else is able to do so; and
(b) allowing shared costs to be allocated in different ways to ensure that only those benefitting from a service pay for it.\(^\text{12}\)

(2) The framework needs to be able to regulate the relationship between more than one building where there are shared areas, such as shared car parks or gardens.

(3) The framework needs to strike an appropriate balance between standardisation and flexibility. The framework will need to be sufficiently sophisticated to accommodate the variety of interests that may exist in a mixed-use or multi-block development. In short, commonhold must give developers the necessary flexibility to build commonhold developments as they currently do. However, making the commonhold scheme more sophisticated inherently risks making commonhold more complicated. We do not think the new management framework should add any more complexity than is necessary, and have considered the additional complexity created by each option of reform. Additionally, we are mindful not entirely to lose the benefit of standardisation, which is one of commonhold’s advantages over leasehold.\(^\text{13}\) Standardisation should make conveyancing simpler and cheaper, and make it easier for homeowners to understand their rights and obligations. We explain how commonhold can offer standardisation, and the advantages of this, in Chapter 1.

(4) The framework should facilitate consumer protection to ensure that abuses that have arisen in the residential leasehold context cannot be transposed into commonhold.\(^\text{14}\) In Chapter 1 we explain that we are keen to prevent, so far as possible, abuses which have been seen in the leasehold sector being replicated in commonhold. When considering options for reform in this chapter we have taken into account the extent to which each option facilitates consumer protection.

\(^\text{12}\) For some less complex commonholds, it may be sufficient for the shared costs to be allocated in different ways depending on the cost incurred, without needing any corresponding differentiation in voting rights. This possibility is discussed in ch 10.

\(^\text{13}\) See para 1.28.

\(^\text{14}\) See paras 1.62, 1.68 and 1.73 to 1.76.
Consultation Question 16.
5.15 We provisionally propose that any new management structure needs to meet the following objectives:

1. Provide the ability to separate out the management of a variety of different interests within the same development, in particular by:
   a. differentiating voting rights, so that those affected by a decision are entitled to participate in making that decision, and no one else is able to do so; and
   b. allowing shared costs to be allocated in different ways to ensure that only those benefitting from a service pay for it.

2. Provide a framework which can be used to regulate the relationship between more than one building where there are shared areas, such as shared car parks or gardens.

3. Strike an appropriate balance between standardisation and flexibility.

4. Facilitate consumer protection to ensure that abuses that have arisen in the residential leasehold context cannot be transposed into commonhold.

Do consultees agree?

5.16 Are there any other objectives which should be added to the list above?

PROPOSALS FOR REFORM

5.17 The commonhold-equivalent models in other jurisdictions\(^{15}\) have had to accommodate mixed-use and multi-block developments without recourse to leasehold. These regimes adopt one (or both) of the following frameworks to separate out different interests: the use of “flying” commonholds, and layered commonholds. Both of these were, in fact, considered during the development of the current law on commonhold, but not adopted.\(^{16}\) We consider both options below, and outline the problems with adopting each of them. We then present a third option – the use of sections to separate out interests within the same commonhold – which may help address these problems, and provisionally propose this third model as the preferred solution.

\(^{15}\) Often called “strata title”, “condominium” or “unit title”.

\(^{16}\) See Commonhold: Legislative History paras 1.28 to 1.39.
Option 1: Flying commonholds – creating a commonhold out of part of a building

What are flying commonholds?

5.18 A “flying freehold” is a freehold which in part or in whole does not touch the ground, and consequently is situated above another freehold. For instance, a first-floor flat is situated above the ground-floor flat, and so would be a flying freehold, if sold on a freehold rather than leasehold basis. Currently, a commonhold cannot be created from a flying freehold.\(^\text{17}\) This restriction means that it is not possible to create a commonhold of only the upper floors of a building.

5.19 It would be possible to amend the law so as to permit a commonhold to be formed out of a flying freehold. If it were permitted to create a commonhold from a flying freehold, the resulting “flying commonhold” would enable different interests in one building to be separated. For example, it would be possible to create a commonhold of only the upper floors of a building, with the ground floor premises being excluded from the commonhold. Commonhold could therefore be used for the common example of residential flats above a shop or other non-residential element. In the example set out in figure 15 above, the flying commonhold model could be used in Building A to set up a commonhold association governing the top two residential floors only. The developer would then have the choice whether to create a separate commercial commonhold, or retain the commercial units on a freehold basis and lease them (see figure 16 below).

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\(^{17}\) In other words, a commonhold must extend down to ground level: CLRA 2002, sch 2 para 1.
Advantages of flying commonholds

5.20 Flying commonholds create a similar scenario to where there are two or more separate commonholds which share facilities (see paragraph 5.10(2) above).

5.21 The advantage of flying commonholds over the current position is that different parts of the same building could be separated out, rather than being limited to just separating out different buildings. For instance, in the example at figure 16 above, the obligations in the CCS would only apply to the six residential units. The commercial units would not be part of the commonhold, and so the commonhold association could not make decisions about the commercial areas. Equally, the commercial unit owners could not interfere with decisions relating solely to the management of the residential units.

Disadvantages of flying commonholds

5.22 If the law were amended to permit flying commonholds, there would be no framework in place to manage the areas shared between the flying commonholds or between the flying commonhold(s) and other property. Using the example above, there would be no framework to regulate the relationship between the flying commonhold set up to manage the residential part of Building A and the non-residential elements retained by the freeholder. Whilst the commonhold association for the flying commonhold would have its own CCS and articles of association, these documents would only govern the internal operation of the commonhold (such as the relationship between the unit owners and the association). There would be no prescribed documentation to regulate the building as a whole.

5.23 Flying commonholds do not resolve the issues discussed at paragraph 5.12(2) which arise where multiple commonholds share facilities. The issues may in fact have more serious consequences for flying commonholds, as the areas which benefit both the flying commonhold(s) and any other units in the same building will include essential parts of the building. For example, the roof in figure 16 would have to be owned by either the commonhold association or the original freeholder of the non-residential parts. Assume the roof is owned by the original freeholder: the freeholder could make the decision to have an entirely new roof put on, rather than just patch a leak. It would then be possible to require the commonhold association to contribute towards this cost through the various workarounds discussed at paragraph 5.10(2) above. However, as in the scenario of multiple commonholds with shared areas, the commonhold association would have had no say in whether to replace the whole roof or just patch the leak.

5.24 In New South Wales, this particular problem is addressed by the creation of a “building management statement”. This statement binds every owner in the building (whether a commonhold unit owner or not). The statement will regulate how the building is to be maintained, who makes decisions about maintenance and who is responsible for contributing financially. However, such a statement relies on positive obligations, which are not currently enforceable in England and Wales. If land obligations, as discussed at paragraph 5.10(2)(a) above, are introduced, it may be possible to regulate the relationship between separate elements of the same building in a similar way to New South Wales. However, we are concerned that land obligations were never intended to be used in such a way. We see two shortcomings of relying on land obligations as a way of facilitating flying freeholds:
Developers would have the flexibility to use land obligations to set up the development as they wish. There would be no way of prescribing the obligations that must be used. Such flexibility comes at the expense of standardisation. A unit owner in one flying commonhold would be under very different obligations from a unit owner in another flying commonhold.

Land obligations do not provide a mechanism for introducing consumer protection. Whilst the prescribed terms of the CCS can be used to provide a degree of consumer protection within a particular commonhold, there would be no limitations on the terms which may be imposed as between the separate flying commonholds (or between a flying commonhold and land retained by a developer). We are therefore concerned that flying commonholds may be used as a way of bypassing consumer protection provisions intended to protect unit owners in commonhold. We understand that some developers in other jurisdictions have used flying commonholds to avoid such requirements.  

We are therefore of the view that even if land obligations, as discussed at paragraph 5.10(2)(a) above, are introduced to overcome the difficulties of enforcing positive obligations, we do not think as a matter of policy that flying commonholds are a suitable means of accommodating mixed-use developments within commonhold. Flying commonholds would not provide an appropriate balance between flexibility and standardisation, or provide adequate consumer protection.

Summary of flying commonholds

In summary therefore, whilst flying commonholds would enable the management of different interests within a development to be separated, they do not provide an adequate framework to regulate areas shared between more than one interest, or more than one building. While the implementation of land obligations following our recommendations on Making Land Work would provide a legal basis for enforcing positive obligations, those proposals have not been designed to create a management framework for commonhold. We consider that a bespoke framework is required to meet the specific needs of commonhold developments. In particular, we are concerned that flying commonholds lose much of the advantages of standardisation and do not easily facilitate consumer protection.

We therefore provisionally suggest that flying commonholds are not a suitable model to introduce to make commonhold work for mixed-use developments, and consequently that it should remain impossible to create a flying commonhold. We do, however, invite consultees’ views on this point, after setting out our provisional proposals for mixed-use and multi-block developments.

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18 For example, see The Owners Corporation Strata Plan 70672 v The Trustees of the Roman Catholic Church for the Archdiocese of Sydney [2011] NSWSC 973.

Option 2: Layered commonholds – a management structure for separate commonholds

What are layered commonholds?

5.28 Many other jurisdictions provide for the creation of commonholds which have multiple layers, with a number of separate sub-associations linked together as part of an overarching umbrella association. The current commonhold model does not allow such structures to be created.

5.29 Changing the law to facilitate layered commonholds in England and Wales would allow different parts of a development (including, in some instances, different parts of a building) to be organised into separate sub-commonholds. Each sub-commonhold would have its own commonhold association, and would be responsible for its own interests and costs. At the same time, the sub-commonholds would be part of an umbrella association which would manage the interests common to the whole development.

5.30 A layered commonhold model could be applied to the example development in figure 15 in the following way.

1. An umbrella association would be set up, which would own the driveway and the car park (the areas of land common to both buildings).

2. Two sub-commonholds, with their own commonhold associations, would be created in respect of Buildings A and B.
   (a) The commonhold association for sub-commonhold A would own and manage all the common areas which are shared between the commercial and residential elements of Building A; for example, the structure and exterior of the building.
   (b) Sub-commonhold B’s association would own and manage all the common areas within Building B.

3. Sub-commonhold A would then be further divided to separate the residential and commercial units.
   (a) Sub-commonhold A1 would be created for the residential owners living in the top two floors of the building. The association of this sub-commonhold would own and manage all the common parts specific to these floors only, for example any shared hallways and staircases.
   (b) The commercial units could form another sub-commonhold. However, stakeholders have told us that commercial unit owners are unlikely to want

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20 For example, “community schemes” in New South Wales, “sections” in British Columbia and “master/subsidiary associations” in New Zealand and the USA. There are some subtle differences between whether the umbrella association delegates certain powers to the smaller subsidiary associations, or whether a number of smaller associations delegate certain powers up to an umbrella association. See further, Commonhold: Comparative Research.
to form their own commonhold. The commercial units could instead remain as individual members of sub-commonhold A.

5.31 Figure 17 illustrates the structure that could be created by applying the layered commonhold model to this example development.

**Figure 17:**

![Umbrella Association Diagram](image)

**Advantages of layered commonholds**

5.32 Introducing layered commonholds provides a solution which would, to some extent, satisfy all of the objectives set out above. Through the creation of multiple sub-commonholds, the management of different interests (either in the same building, or across the development) can be separated. Common parts would belong to the sub-commonhold association which benefited from them. Votes and shared costs can then be allocated accordingly. The umbrella association would own the common areas shared by the whole development, and would provide a framework to regulate the relationship between the different buildings and different interests.

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21 Stakeholders additionally raised concerns that any provisions requiring commercial unit owners to form a commonhold may reduce the market value of these commercial units. It is also likely that in practice the commercial units will all be owned by the same person (who then leases them out to commercial tenants). Requiring a single person to form a sub-commonhold association would be artificial.

22 See para 5.14 above.
5.33 Layered commonholds would therefore introduce the necessary sophistication to allow developers to create commonholds which combine a number of different uses and/or separate blocks. At the same time, the layered framework still provides a certain measure of standardisation. The same framework of umbrella and sub-commonhold associations will apply across all commonholds which have needed to separate out various interests (albeit in different arrangements). Consequently, an individual could move from one layered commonhold to another, and still have some understanding of how the structure fits together, and where to find various provisions and information.

5.34 The layered commonhold model also facilitates consumer protection, as each sub-commonhold will have a CCS and articles of association. The relationship between each sub-commonhold will be governed by the CCS of the umbrella association. The detailed statutory provisions and limitations of both the CCS and articles of association can be used to provide the desired degree of consumer protection in layered commonholds.

5.35 However, as explained above, we consider the level of complexity of any new management structure is an important factor when deciding between different options for reform. We set out below the inherent complexity of layered commonholds, and provisionally conclude that due to the level of complexity this model is not suitable to govern mixed-use and multi-block developments.

Disadvantages of layered commonholds

5.36 The layered commonhold model involves a high level of complexity, largely arising from the need to have numerous commonhold associations within one development. This complexity is apparent in other jurisdictions which adopt a layered commonhold model. For instance, in New South Wales there are two statutes containing a total of over 200 sections and 19 schedules, which solely deal with the layered-commonhold-equivalent. The British Columbia Law Institute has recently published a consultation paper looking at the issues affecting British Columbia’s model of layered commonholds. They noted that critics often refer to the “administrative complexity, duplication in procedures, potential conflicts of interests for service providers, and added costs” resulting from each sub-commonhold being its own company.

5.37 These complexities would be even greater if layered commonholds were adopted in England and Wales, as each of the sub-commonhold associations would have to be a limited company, regulated by general company law and registered at Companies House. We outline below the main areas in which this complexity arises.

(1) Membership and representation: The commonhold associations at each layer are corporate bodies, and consequently must have both members and directors. Some associations will just have unit owners as members (such as sub-commonhold A1 in figure 17). However, other associations will have sub-

23 See further discussion in chs 1 and 8.
26 See further ch 7 which discusses why we propose retaining the current company structure of the commonhold association. Other jurisdictions use bespoke corporate structures for the commonhold association, which are not regulated in the same way as general companies. See also Commonhold: Comparative Research.
commonhold associations as members (such as the umbrella association in figure 17), or sometimes a mix of unit owners and sub-commonhold associations (for instance, sub-commonhold A in in figure 17).

Establishing how to ensure that the members of an association are fairly represented is a difficult exercise. For instance, where the members are all sub-commonhold associations of the same size, it might seem obvious for each sub-commonhold to be entitled to elect a director. However, some developments may end up with a large number of sub-commonholds, potentially resulting in the umbrella association having a board of 40 or more directors. This approach is also harder to apply where the members are a mix of unit owners and sub-commonhold associations, and where the associations are different in size. A highly nuanced and complicated framework would be needed to achieve fair representation in all of the possible scenarios.

(2) **Voting:** It would be necessary to establish how a sub-commonhold association is to vote in a decision taken by an association of which it is a member. For instance, if the umbrella association is required to carry out a vote of members on a particular decision, the sub-commonhold association (such as sub-commonhold association A1 in figure 17) as a member will be able to vote. It might be that the sub-commonhold nominates a representative to vote on its behalf, or that the sub-commonhold must first carry out a vote on the same issue to determine how it will then vote as a member of the umbrella association. Establishing how votes are to be allocated and the majorities needed at each stage is a complex exercise, especially where the relevant members are a mix of unit owners and sub-commonhold associations.

(3) **Finding enough directors:** As every sub-commonhold will have its own commonhold association, each sub-commonhold will be required to have at least two directors, in addition to the umbrella association having two directors. For example, the development in figure 17 above would require at least ten directors. Many developments are much larger than this. Stakeholders have told us that in leasehold developments, it can be difficult to get leaseholders to engage in management, and that it can be difficult to find enough directors for a leaseholder-owned management company. It may therefore be a significant challenge to find the large numbers of directors that might be required in layered commonholds.

(4) **More documents:** Each commonhold association in a layered commonhold will have its own CCS. This potentially adds a great deal of complexity for unit owners, who would need to read more than one CCS to understand fully their rights and obligations. The increased documentation could also add delays to the conveyancing process. Unless a significantly different form of CCS is created for layered commonholds, it is difficult to see how the need for multiple CCSs could be removed. Additionally, each association would produce its own budget.

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27 For instance, allowing both a section comprised of three commercial units and section comprised of 50 residential units to each appoint one director will not necessarily result in fair representation for all the unit owners.

28 Although see the discussion above about the complexities surrounding representation.
meaning unit owners would have to read more than one budget to fully understand what they were contributing towards.

(5) **Duplication:** Each commonhold association within a layered commonhold will be regulated by general company law and must be registered at Companies House. Consequently, each association within the same commonhold will be subject to the general accounting requirements and must complete an annual confirmation statement. For instance, five balance sheets and five confirmation statements would be submitted every year from the layered development in figure 17, covering many of the same details. Additionally, decisions requiring a vote of members may require a duplication of proceedings if each sub-commonhold association must hold a vote before the umbrella association can make a final decision.

(6) **Conflicts of interest:** Layered commonholds could include the possibility for an umbrella association to contract with a sub-association to provide services, such as building management. However, sub-commonhold associations may be reluctant to enter into contracts with the umbrella association, especially for legal or financial services. If such contracts are not used, there is the potential for any professionals (for instance, managing agents, lawyers, accountants) working with more than one of these associations to encounter a conflict of interests. Such conflicts may arise because each commonhold association is its own company, with its own legal identity and its own interests. If a conflict arises and cannot be avoided, then the sub-commonhold or umbrella association will have to choose different professionals to work with, resulting in higher costs and delays.

(7) **Enforcement:** With multiple CCSs in place, enforcement may become a more drawn-out procedure, as a commonhold association can enforce the obligations in the CCS against its members only. For instance, in the development in figure 17, it would be difficult for the umbrella association to take enforcement proceedings if one of the residential unit owners in sub-commonhold A1 had breached a rule set out in the umbrella association’s CCS. The unit owner would only be a member of sub-commonhold A1, and not a member of the umbrella association. This problem could perhaps be addressed by including a provision in the umbrella association CCS stating that all unit owners are considered members of the umbrella commonhold for enforcement purposes. However, a similar provision would also need to be included in the CCS of any sub-commonhold association which has a further sub-commonhold as one of its members.

**Summary of layered commonholds**

5.38 In summary, layered commonholds offer some advantages, allowing the management of different interests within the same development to be separated out, whilst maintaining some level of standardisation. Additionally, layered commonholds provide a mechanism to facilitate consumer protection. However, we consider that the inherent complexity of layered commonholds is such that layered commonholds would be an inappropriate framework to manage mixed-use and multi-block commonholds. We

29 “Confirmation statements” replaced “annual returns” in 2016. The statement requires certain information about the company to be made public every year, such as whether there has been a change in the board of directors.
therefore provisionally propose that the current position is maintained, with no scope for creating layered commonhold developments. We invite consultees’ views as to this point after setting out our suggested management structure for mixed-use and multi-block developments.

Option 3: Sections – a management structure to separate out interests within the same commonhold

5.39 In view of the difficulties we have identified with layered commonholds, we think it is preferable to provide a management framework which does not require the creation of multiple companies within a commonhold development. We provisionally consider that an appropriate management framework can be provided by the creation of sections within a single commonhold association. Sections are a means of separating different interests within a commonhold without the need for additional corporate bodies. We set out how such a model could operate and make provisional proposals for its adoption.

What are sections?

5.40 This model is in many ways a simplified form of layered commonhold, without each sub-commonhold having to be an individual company. “Sections” would allow units to be grouped in accordance with their particular interest. An amendment could be made to the model CCS to facilitate their creation, by effectively creating different membership classes within a single commonhold association.30

5.41 Once the membership classes have been set up, the CCS could then set out the issues which are only paid for, and therefore can only be voted on, by members who are part of a certain section. Some decisions could be open to multiple sections, some to just one, and some to all. This framework would allow one part of a development to be responsible for specific costs, and allows that part to take the corresponding decisions independently of the rest of the development.

5.42 To make it clear which rights and responsibilities each section has, it might be desirable for some of the common parts to be designated to specific sections by the CCS. Doing so could help to ensure the costs of upkeep and decision-making powers are allocated correctly. There would need to be accompanying plans which clearly define these designated areas, to ensure the responsibilities of each section are clear.

5.43 Sections could be applied to the example development in figure 15. A single commonhold association would be created for the whole development, including both buildings, the shared driveway and the car park. The developer setting up the commonhold would then have freedom to decide how the units would be split into different sections.31 One possible option is set out in figure 18 below. Alternatively, the developer could create separate sections for each of the hotel, offices and retail units, rather than grouping all three together into one section.

30 Different classes of membership within a single company are provided for by the Companies Act 2006, ss 629 to 640. For more discussion of class rights within companies limited by guarantee, see M Mullen and J Lewison, Companies Limited by Guarantee (4th ed 2014), paras 4.11.1 to 4.11.3.

31 Although the sections could be changed by a vote of the unit owners at a later date – see para 5.84 onwards.
Figure 18: Commonhold Association

Building A

Section 1
Residential

Section 2
Hotel

Office

Retail

Building B

Section 3
Residential
5.44 The CCS could then designate responsibility for certain common parts to each section, perhaps in the following way. 32

(1) The common areas internal to the top two floors of Building A are designated to Section 1 only (for instance, any hallways, lifts or stairwells used by the residential units only).

(2) The common areas internal to the bottom three floors of Building A are designated to Section 2 only (for instance, any lifts or stairwells used by all of the commercial units, but not the residential units).

(3) The common areas that form the exterior of Building A, and any other structural elements of Building A are designated to Sections 1 and 2 only.

(4) The common areas that form Building B, both the exterior and interior, are designated to Section 3 only.

(5) The non-designated common parts of the development, such as the driveway and car park, remain the responsibility of all sections, through the commonhold association.

Advantages of sections

5.45 Introducing sections would enable commonhold to separate out different interests in the same development whilst also providing a mechanism for governing shared areas. Below we explore the three main advantages we think sections can offer in contrast to flying or layered commonholds:

(1) by not relying on creating multiple commonhold associations within the same development, sections avoid, or greatly reduce, the problems that arise in layered commonholds;

(2) sections strike a better balance between flexibility and standardisation than flying commonholds; and

(3) sections are better able to facilitate consumer protection than flying commonholds.

5.46 For these reasons, we provisionally propose below that sections would be an appropriate management structure to introduce to make commonhold workable for mixed-use and multi-block developments.

5.47 We then go on to examine how specific aspects of commonhold with sections would operate, and invite consultees to share their views on each of these areas.

32 In practice this would be more complex and detailed, and would have to be accompanied by plans carefully demarcating each designated area. For example, a floor plan of Building B would be required, showing the gym, and any stairwells or lifts.
Overcoming the complexities of layered commonholds

5.48 At paragraphs 5.36 and 5.37(7) above, we set out the main issues that we think prevent layered commonholds from being a suitable model. Many of these issues are resolved, or at least greatly reduced, by the use of sections rather than layered commonholds.

(1) Reduced complexity surrounding membership and representation in commonhold associations: With sections, issues about membership are avoided as there is only one commonhold association, and every unit owner will be a member of that association. Complexities surrounding representation can also be reduced to some extent, by addressing representation through a combination of elected directors and / or section committees. However, section committees do raise a number of questions which must still be resolved before they can be adopted.33

(2) Reduced complexity setting out voting provisions: Sections present fewer layers of complexity around voting provisions – unit owners as individuals are either entitled to vote on a matter, or not. Unlike in layered commonholds, it does not have to be considered whether a “pre-vote” has to take place, and under what conditions, in order for some unit owners to direct their representative how to vote on their behalf.

(3) Less difficulty finding enough directors when creating several companies, each requiring two directors: In a commonhold with sections, there will only be a single commonhold association. Consequently, the minimum number of directors required for the entire development would be two – a significantly lower requirement than layered commonholds. If section committees are adopted (which we discuss in paragraphs 5.59 to 5.80 below), then members would need to be found for these committees. However, these committees could be formed of just one person, and may not, in fact, be mandatory for every section.

(4) Fewer conflicts of interest for service providers: As a development will only have one commonhold association who can employ service providers, the potential for conflicts of interest present in layered commonholds is greatly reduced.

(5) Avoiding duplication of procedures resulting in higher costs: Again, as there is a single commonhold association, duplication should be avoided, or at least significantly reduced. Only a single budget is required, along with a single set of accounts, and a single voting process for each decision.

(6) Fewer documents that unit owners are required to read to understand their rights and obligations: Unlike in layered commonholds, in a commonhold with sections there is only one CCS for unit owners to read. That CCS may be more lengthy than each individual CCS in a layered commonhold, but should make it easier for unit owners to understand their rights and obligations as they only have to read one document. In Chapter 8 we discuss some potential options for how the layout of the CCS could be improved to make it easier for unit owners to identify their specific rights and obligations.

33 See para 5.58 onwards for a discussion of directors and section committees.
Less difficulty with enforcement: Again, as there is only one CCS and one commonhold association in a commonhold with sections, the complications surrounding enforcement in layered commonholds are reduced. The enforcement proceedings will be unchanged from a standard commonhold with no sections.

The balance between flexibility and standardisation

Sections would introduce significant flexibility into how the commonhold framework can be applied to mixed-use and multi-block developments by allowing different interests to be separated, and costs and voting rights allocated accordingly. Additionally, the extent to which common parts are designated to specific sections can vary from development to development. This flexibility is an important aspect in which sections can enable commonhold to work for a wide variety of developments.

However, sections also allow an element of standardisation to be maintained. As with layered commonholds, the same broad framework will apply across all commonholds which have separated out different interests (albeit in different arrangements). Consequently, an individual can move from one commonhold with sections to another, and still have some understanding of how the structure fits together, and where to find various provisions and information. Additionally, given that a commonhold with sections will only have one CCS and one commonhold association, there will be greater similarity between a commonhold with sections and a commonhold without.

We therefore think that sections strike an appropriate balance between increasing the flexibility of commonhold, and maintaining some standardisation.

Consumer protection

Consumer protection is facilitated in a commonhold with sections, through the CCS and articles of association which apply to the whole development. Both the CCS and articles of association have detailed provisions and limitations set out by statute. Therefore, they can be used to provide the desired degree of consumer protection in commonholds with sections. This position is preferable to that of flying commonholds, which would depend solely on the general law to determine what types of obligations can be imposed on unit owners.

Disadvantages of sections

Although the sections model has many advantages, the disadvantages must also be taken into account. There will necessarily have to be some level of complexity, in setting out the provisions which separate out the financial contributions and voting rights. The CCS will also have to be accompanied by detailed plans carefully demarcating each designated area. In the example above, for instance, a floor plan of Building B would be required, showing the gym, and any stairwells or lifts. However, we think that making commonhold usable for mixed-use and multi-block developments necessarily involves a greater degree of complexity than exists in the current model. As set out above, the sections model would introduce a lesser degree of complexity than layered commonholds, and is therefore preferable.
5.54 Additionally, under the sections model, only the commonhold association (and not each individual section) could enter into contracts. This point is discussed in more detail below,34 along with provisional proposals to address the issue.

Consultation Question 17.

5.55 We provisionally propose that commonholds with sections (which are not individual corporate bodies) should be introduced as a management structure to make commonhold workable for more complex developments.

Do consultees agree?

5.56 If consultees do not agree, do consultees prefer either the flying commonhold model or layered commonhold model? If so, how do consultees suggest addressing the issues with these models?

5.57 Are consultees aware of any other options we should be considering?

Specific aspects of the sections model

5.58 In addition to provisionally proposing the broad framework of sections as a way of managing mixed-use and multi-block developments within commonhold, we think it would be helpful to examine in more detail a number of specific aspects of the sections model.

Representation and section committees

5.59 As there is only one commonhold association for the whole development, there will only be one board of directors. These directors will be elected by all the unit owners, in line with their voting entitlements set out by the CCS.

5.60 We considered whether each section should be entitled to appoint one director, rather than all sections voting on all the directors. However, this approach would potentially replicate one of the problems with layered commonholds, in terms of how many directors may be required in total.

5.61 Allowing each section to form its own committee provides an alternative way of making it possible for sections in both large and small developments to have its own representative. If section committees were set up, the board of directors could then delegate certain powers to each committee.

5.62 This approach could give unit owners in a particular section greater control over the management of their section. It would allow day-to-day management decisions that affect only one section to be taken by one or more representatives elected by that section, as opposed to directors who have been elected by the whole commonhold. Whilst the directors are under a duty to act in the best interests of the whole commonhold, which may help prevent one section being favoured over another, section

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34 See paras 5.69 to 5.70 below.
committees may allow those with a greater understanding of the needs of that section to make the day-to-day decisions. It may also give a greater sense of control to unit owners in the particular section.

5.63 The Commonhold Regulations currently allow the directors of a commonhold association to delegate powers to a committee. However, this delegation:

is subject to the provisions of the commonhold community statement, may be made subject to any conditions the directors may impose, may be made either collaterally with or to the exclusion of their own powers, and may be revoked or altered.\(^{35}\)

5.64 This provision raises a number of questions which must be answered in the context of section committees.

1. Should the creation of, and consequent delegation to, section committees be optional for each commonhold to decide, or should it be mandatory?

2. Should powers delegated to a section committee be capable of being exercised exclusively by that committee (exclusive delegation), or be capable of being exercised by the directors as well (collateral delegation)\(^ {36}\) - or should that be for the directors to decide in each case?

3. How can delegation of powers to section committees be revoked or altered?

**Mandatory or optional?**

5.65 It would be possible for sections to be set up without section committees. Sections are the means by which different interests within a commonhold can be separated, and the voting rights and financial obligations accordingly allocated. Section committees are one option for giving a particular section greater control over the day-to-day management of issues within its responsibility. If sections are created without section committees, the directors as a whole would take responsibility for the day-to-day management of each section.

5.66 It would be possible to make it mandatory for every section to have a section committee. To give any meaning to this requirement, it would also have to be mandatory for section committees to be given certain powers by the directors. Mandatory section committees would bring increased standardisation between sections across developments. It would also ensure that all sections had the benefit of greater control over the management of their section, as discussed in paragraph 5.62 above.

5.67 However, we do not think that it should be mandatory for every section to have a committee, for the following reasons.

5.68 First, much of the benefit of using sections to separate out voting rights and financial obligations for different interests in a development can be gained without having a section committee in place. If section committees are optional, only those sections who

\(^{35}\) Commonhold Regulations 2004, sch 2 para 55. See further discussion of collateral and exclusive delegation at paras 5.73 to 5.77 below.

\(^{36}\) We have adopted the term collateral delegation as it is used in the Commonhold Regulations 2004. This type of delegation may also be described as concurrent.
are interested in taking greater control over their management would create a section committee. This approach gives flexibility for such control where it is wanted, but avoids introducing extra administration and complexity where it is not.

5.69 Secondly, making section committees and the delegation of specific powers mandatory might place the commonhold association in a vulnerable position. Because a section committee is not a corporate body, it will not have its own legal identity. A section committee would therefore not be able to enter into contracts with third parties in its own name. Instead, it would need to bind the whole commonhold association into these contracts, under the authority delegated to it by the directors.

5.70 The costs of any contract could be allocated to the specific section under the provisions of the CCS, but if the section fails to pay, the contractor would then be able to enforce the debt against the whole commonhold association. Risks to the association can be more easily mitigated where any delegation of directors’ powers is optional.

(1) If delegation is optional, the directors have the chance to consider the risks in their particular development, and make any delegation of powers accordingly.

(2) The directors could attach conditions to their delegation, such as a requirement to obtain the directors’ consent if the value of the contract is above a certain threshold. Although thresholds could be set by statute if section committees were made mandatory, such a statutory cap may be difficult to apply, given the potential for significant variation between developments. What is appropriate for a development with two small sections and a development with 20 large sections may be very different.

(3) Additionally or alternatively, the directors could choose to allow section committees only to bind the whole association where the necessary funds have already been collected.

We provisionally propose that it should be optional, rather than mandatory, for a section committee to be set up for each section in a commonhold.

Consultation Question 18.

5.71 We provisionally propose that it should be optional, rather than mandatory, for a section committee to be set up for each section in a commonhold.

Do consultees agree?

5.72 If consultees disagree, which powers do consultees think should be given compulsorily to those committees?

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37 See ch 7 on insolvency for further discussion of what may happen in this instance.
Collateral or exclusive delegation?

5.73 Directors of commonhold associations can currently delegate power in two ways:

(1) collateral delegation, which means that the directors retain their power to make the delegated decisions, so both the committee and the directors have power to make delegated decisions; or

(2) exclusive delegation, which means that the directors give up their power to make certain decisions, so only the committee has the power to make those decisions.

5.74 Exclusive delegation would give section committees control of the day-to-day decisions affecting their sections. If directors retain the power to make the same decisions as the section committee, the control which section committees can offer to unit owners in a particular section might be significantly diluted.

5.75 However, there may be good reason for allowing directors to delegate collaterally to section committees. Without its own legal identity, a section committee cannot own the common parts which are designated to that section. Therefore, the commonhold association as a whole will remain the owner of all the common parts, and so the association is ultimately responsible for maintaining the common parts. This includes any common parts which the CCS has designated responsibility for to specific sections.38

5.76 If powers are delegated exclusively to section committees, then it may be difficult for directors to ensure that the commonhold association is meeting its obligations. If a section committee is causing the commonhold association to fail in its duties, it would be hard for the directors to address this failure without going to court. In contrast, collateral delegation would enable the directors to step-in to ensure the commonhold association complies with its obligations in the CCS. Collateral delegation therefore potentially provides a framework for oversight of section committees by the directors, which may help encourage good management by section committees.

5.77 We invite consultees to share their views as to whether delegation to section committees should be collateral or exclusive; whether this should vary for different powers; or whether it should be for each commonhold to decide.

Consultation Question 19.

5.78 We invite consultees’ views as to whether delegation to section committees should be collateral or exclusive; whether this should vary for different powers; or whether it should be for each commonhold to decide.

38 See para 5.42 above for examples of how responsibility for common parts might be delegated to sections.
Revocation and alteration of powers delegated to a section committee

5.79 Currently, directors of a commonhold association are able to revoke or alter delegated powers as they wish, in line with general company law practice. This position could continue unchanged. However, unit owners may have purchased property in the commonhold with the expectation that their section committee has certain powers. It might therefore be appropriate to give section committees affected by such a decision the ability to apply to the First-tier Tribunal (Property Chamber), or in Wales the Residential Property Tribunal Wales (“the Tribunal”). In Chapter 13 we consider the test which may be applied by the Tribunal and the remedies which may be available.

5.80 Alternatively, the directors could be required to apply to the Tribunal for an order temporarily (or permanently) suspending or altering the delegation. Requiring the directors to apply to the Tribunal before might provide greater certainty for unit owners, but would be a significant limitation on directors’ powers. We invite the views of consultees as to which approach is preferred.

Consultation Question 20.

5.81 We invite consultees’ views as to whether:

(1) directors should be able to revoke or alter the powers delegated to a section committee as they wish;

(2) section committees affected by an alteration of delegated powers should be given the ability to apply to the Tribunal; or

(3) the directors should have to apply to the Tribunal in order to alter or revoke a delegation.

Costs and voting rights

5.82 Sections provide greater flexibility over how costs can be allocated across the development. Voting rights could be allocated to reflect the allocation of costs, so that only those who will have responsibility to pay for something will be entitled to vote on it. For instance, for the example development in figure 18, the CCS could allocate costs (and therefore voting rights) in the following way.

(1) Unit owners in Section 1 are responsible for paying costs associated with decisions which affect Section 1 only. This includes any decisions relating to areas designated to Section 1 only (such as whether to install a video entry system), and the maintenance and upkeep of these areas. Unit owners in Section 1 only will be entitled to vote on these matters.

(2) Unit owners in Section 2 are responsible for paying costs associated with decisions which affect Section 2 only. This includes any decisions relating to areas designated to Section 2 only (such as whether to install CCTV for any lifts or stairwells used by the commercial units, but not the residential units), and the
maintenance and upkeep of these areas. Unit owners in Section 2 only will be entitled to vote on these matters.

(3) Unit owners in Sections 1 and 2 are responsible for paying costs associated with decisions which affect the whole of Building A only (such as whether to install solar panels on the roof). Unit owners in Sections 1 and 2 only will be entitled to vote on these decisions.

(4) Unit owners in Section 3 are responsible for paying costs associated with decisions which affect Building B only (such as whether to remove the concierge service, or repaint any shared hallways), and for the maintenance and upkeep of the areas designated to Section 3 only. Unit owners in Section 3 only will be entitled to vote on these matters.

(5) The gym in Building B may only be used by unit owners in Section 3. Unit owners in Section 3 only are responsible for paying costs associated with decisions affecting the gym, and unit owners in Section 3 only will be entitled to vote on these matters.

(6) Any other costs not set out above will be shared between all the owners in all sections. All other decisions, including those relating to the driveway and car park, may be voted on by all unit owners in all sections.

5.83 The total costs, for which each section was responsible, would then be shared between the unit owners in that section, in the proportions set out by the CCS. A similar approach could be used for reserve funds. Three separate reserve funds could be created, one for each section, and each section would only contribute to its own reserve fund. Separate reserve studies could be carried out for each section, so that each reserve fund reflects the needs of that specific section. More than one reserve fund could be set up for each section, if appropriate.39

Creating sections

5.84 One question to be resolved is when and how sections can be created. It would seem sensible to allow sections to be created at two different points in time: by the developer at the outset; and by the commonhold association at a later point. This approach gives flexibility for developers to set up mixed-use or multi-block developments as they see fit. The unit owners, after having experienced living in the commonhold, could also collectively restructure the commonhold should they feel that is desirable. This approach reflects that taken in other jurisdictions40 in the context of layered commonholds, where similar questions arise as to how and when sub-commonholds can be created.

5.85 If the commonhold association should be able to create sections at a later date, the question arises as to what majority vote is needed for the commonhold association to create a section, and consequently restructure voting rights in the commonhold.

39 A reserve fund is a pool of money which is set aside to cover the costs of future, one-off or major works needed in the commonhold, such as replacement of the lift or roof. See further ch 10, para 10.47 onwards.

40 For example, New Zealand and British Columbia.
5.86 In New Zealand and British Columbia, the commonhold association for the whole development must agree to the creation of a sub-commonhold by a 75% majority of those voting.41 Given that a new class of voting rights (and corresponding financial obligations) will be created when a section is created, it would seem appropriate that, in England and Wales, a special resolution,42 rather than an ordinary resolution, should be required.43 However, the 75% majority required for a special resolution does not necessarily guarantee that unit owners in the new section are in favour of the decision, and our proposals may result in an alteration of unit owners’ financial obligations and corresponding voting rights. For instance, instead of the costs of maintaining the roof on the building which forms the new section being contributed to by all unit owners on the development, the costs might now only be split between the unit owners in that new section. To address this possibility, we provisionally propose an additional requirement that at least 75% of the total votes held by the unit owners who would be part of the new section must have been cast in favour of creating the section.44

5.87 As an additional protection, we provisionally propose that unit owners affected by the introduction of a new section should be given the option of applying to the Tribunal. In Chapter 13 we consider the test which may be applied by the Tribunal and the remedies which may be available.

Consultation Question 21.

5.88 We provisionally propose that a new section should be able to be created by:

(1) the developer, at the outset; and
(2) the commonhold association at a later date.

Do consultees agree?

5.89 If the commonhold association is allowed to create sections after it has been set up, we provisionally propose that this decision should be approved by special resolution, with the additional requirement that at least 75% of the total votes held by the unit owners who would be part of the new section must have been cast in favour of creating the section.

Do consultees agree?

5.90 We provisionally propose that unit owners affected by the introduction of a new section should be given the option of applying to the Tribunal.

Do consultees agree?

41 New Zealand Unit Titles Act 2010, s 20(4).
42 A special resolution requires either 75% of the votes cast to be cast in favour if the vote is taken at a meeting, or 75% of all votes in the commonhold to be cast in favour if using the written resolution procedure.
43 An ordinary resolution requires either over 50% of the votes cast to be cast in favour if the vote is taken at a meeting, or over 50% of all votes in the commonhold if using the written resolution procedure.
44 This would be 75% of those unit owners present and voting. It would only require the consent of 75% of all the unit owners who would form the new section if the decision was taken by written resolution. The Companies Act 2006 discusses written resolutions at ss 288 to 300.
5.91 It must also be considered whether there should be qualifying conditions for creating sections. The main disadvantage of introducing qualifying criteria for sections is the consequent reduction in flexibility. However, qualifying criteria for sections would give some measure of standardisation as to what constitutes a section from one development to another.

5.92 Qualifying criteria may help preserve, so far as possible, the “underlying ethos” of commonhold – the idea of collective, democratic responsibility for the development, where unit owners have similar interests. As discussed above, this commonality of interest does not always exist between all the unit owners in a complex development, and sections may be an appropriate way to address this. Introducing qualifying criteria would mean that sections would only be created for good reason and so the underlying ethos would not be unnecessarily diluted.

5.93 Considering the examples of complex, mixed-use and mixed-tenure developments that stakeholders have shared with us, we provisionally propose that qualifying criteria are introduced, so that sections can only be created to give separate classes of vote to:

1. residential and non-residential units;
2. non-residential units, which use their units for significantly different purposes;
3. different types of residential units (such as flats and terraced houses);
4. separate buildings in the same development; and
5. other premises falling within the commonhold which, in the interests of practicality and fairness, the Tribunal decides should form a separate section.

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45 See para 5.12(1) above.
46 The first three situations on this list reflect the circumstances in which the creation of a sub-commonhold is permitted in British Columbia.
47 Enfranchisement law currently includes the concept of a “self-contained building or part of a building” to deal with the concept of separation (see the Enfranchisement Consultation Paper, paras 7.70 to 7.73). However, we propose that it should only be possible to create sections for separate buildings (and not parts of a building which are self-contained). The current enfranchisement definition would exclude buildings where part of another building underhangs or overhangs. We think that any definition adopted in commonhold would need to be broader than that used in enfranchisement, so as not to exclude buildings with an overhang or underhang (eg a basement carpark underneath two blocks).
Consultation Question 22.

5.94 We provisionally propose that qualifying criteria for sections should be introduced, so that sections can only be created to give separate classes of vote to:

(1) residential and non-residential units;
(2) non-residential units, which use their units for significantly different purposes;
(3) different types of residential units (such as flats and terraced houses);
(4) separate blocks in the same development; and
(5) other premises falling within the commonhold which, in the interests of practicality and fairness, should form a separate section.

Do consultees agree? Are there any other criteria which consultees feel should be added to the list?

5.95 Although a commonhold cannot, by definition, contain a single unit, we propose that a section should be able to contain only one unit. This provision would allow sections to be used in situations such as a block of three residential flats above one commercial unit to separate the residential and commercial interests. Additionally, it may often be the case that where there are multiple commercial units, they will all be owned by the same person and then leased to commercial tenants. Therefore, even if there are multiple commercial units in the same section, there may still only be a single unit owner. It would be arbitrary to allow a section to consist of a single unit owner where they own more than one unit, but not where they only own one.

Consultation Question 23.

5.96 We provisionally propose that it should be possible for sections to consist of a single unit.

Do consultees agree?

Combining sections

5.97 There may be situations where a commonhold association wants to combine two or more sections. For example, a block with three residential flats above one commercial unit might have two sections: a residential section and a commercial section. If the use of the commercial unit changes to become residential, it would make sense to combine the two sections so that all the residential units are part of the same section.

5.98 The restructuring of a commonhold by combining two or more sections has parallels with the restructuring of a commonhold by creating a new section. Restructuring will also affect which decisions unit owners are entitled to vote on, and the costs they have
to contribute towards. We therefore provisionally propose that the same majority vote is needed to combine two or more sections as would be needed to create a new section. As discussed in paragraph 5.86 above, a special resolution of the commonhold association would therefore be required. Additionally, 75% of the total votes cast by the unit owners in the sections that are to be combined must be in favour.

5.99 Unit owners may still be adversely affected by the combining of sections, as they might be by the creation of sections. We therefore provisionally propose that unit owners affected by sections being combined should be given the right to apply to the Tribunal as an additional protection. In Chapter 13 we consider the test which may be applied by the Tribunal and the remedies which may be available.

5.100 However, in contrast to our proposals for creating sections, we do not think that it would be desirable to have criteria which must be met in order to combine sections. The purpose of having criteria for the creation of sections is to ensure sections are only created where there is good reason to do so. However, we do not propose that it should be mandatory to create sections once the criteria set out at paragraph 5.93 have been met; creating sections would be optional. Consequently, a commonhold which meets the criteria may have no sections from the outset. It would therefore seem appropriate that a commonhold with sections could change to a structure with fewer, or no, sections should it wish to do so. We provisionally propose that there should be no criteria which must be met before two or more sections in a commonhold can be combined.

Consultation Question 24.

5.101 We provisionally propose that to combine two or more sections, a special resolution of the commonhold association should be required. Additionally, 75% of the votes cast by the unit owners in the sections that are to be combined must have been in favour.

Do consultees agree?

5.102 We provisionally propose that unit owners affected by sections being combined should be given the right to apply to the Tribunal as an additional protection.

Do consultees agree?

5.103 We provisionally propose that there should be no criteria which must be met before two or more sections in a commonhold can be combined.

Do consultees agree?
Chapter 6: New commonhold developments and development rights

INTRODUCTION

6.1 Currently, on the sale of the first unit in a new commonhold development, the commonhold association becomes the registered owner of all the common parts of the commonhold. In order to complete works on the development, the developer must reserve certain rights, called "development rights", in the commonhold community statement ("CCS").

6.2 Whilst it is important that developers are able to complete works, and can respond to changing circumstances, it is also important that unit owners have a degree of certainty in the property they are purchasing. These two objectives – flexibility for developers, and certainty for purchasers – are likely to be in tension. The question becomes the best way of striking a balance between the two. Drawing the balance raises questions as to the extent to which a developer may be able to vary the commonhold boundaries, the number of units and facilities, or amend the CCS after a unit has been sold.

6.3 In this chapter, we set out the current procedure for creating new commonhold developments and reserving development rights. We then explain the criticisms of the current law before considering the options for reform.

THE CURRENT LAW

Creating a new commonhold development

6.4 When a new development is established as commonhold, the owners of the commonhold units will not be known at the outset. The registration of a new commonhold development is therefore referred to as “registration without unit owners”.58 Whilst this procedure is clearly intended to be used for new commonhold developments, there is a suggestion that developers may benefit from instead registering “with unit owners”, which is the intended procedure for converting existing buildings to commonhold. We consider this issue later in this chapter, and set out a proposal for reform.

6.5 Registration “without unit owners” is made both where a developer is constructing a new development on open land and where a developer buys and renovates an existing building. The key stages of registration without unit owners are as follows.

(1) The commonhold association must be created and registered at Companies House.49

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48 On the other hand, when converting existing buildings to commonhold, an application will be made to register the commonhold "with unit owners": CLRA 2002, s 9 (see further ch 4).

49 Companies House is the office of the Registrar of Companies, who deals with the registration of all limited companies in England and Wales.
(2) The CCS must be prepared. The CCS should be accompanied by a plan which is clear and accurate, otherwise HM Land Registry may reject the application.  

(3) Consents must be obtained. It is necessary to obtain the consent of certain persons who have an interest in the land on which the commonhold is to be built. The consents required are the same as those that need to be obtained when converting from leasehold to commonhold, (see further Chapter 4).

(4) The owner of the freehold land on which the commonhold is to be created must apply to HM Land Registry to register a freehold estate in commonhold. The person making the application is referred to as “the applicant” and in most cases will be the developer. The application must be accompanied by the following documents which are prescribed by the 2002 Act:

(a) the commonhold association’s certificate of incorporation (which demonstrates that the company has been created) and any altered certificate of incorporation (for instance after a change of name) and its articles of association (“the Articles”);  

(b) the CCS;  

(c) evidence that the necessary consents have been obtained in the prescribed form. The applicant must provide a statement of truth confirming that the necessary consents have been obtained. This acts as conclusive proof that no further consents are required; and  

(d) a certificate given by the directors that the Articles and CCS comply with the 2002 Act and Commonhold Regulations.

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50 Commonhold (Land Registration) Rules, r 8.  
51 CLRA 2002, sch 1 para 6. If consent has been dispensed with, the court order dispensing with the requirement to obtain the consent should instead be provided.  
52 CLRA 2002, Pt 1 s 2(1)(a). This will be the person who is registered as the owner of the freehold estate in land with absolute title or a person who HM Land Registry accepts is entitled to be registered as such. The application must be provided to HM Land Registry in prescribed Form CM1 (Commonhold (Land Registration) Rules, r 5(1)).  
54 The original documents, or a certified copy may be provided. If an original is sent to HM Land Registry, a certified copy must also be provided: Commonhold (Land Registration) Rules, r 4.  
55 CLRA 2002, sch 1 paras 2 to 4.  
56 CLRA 2002, sch 1 para 5.  
57 Prescribed form CON1 is to be used: Commonhold (Land Registration) Rules, r 7.  
58 Commonhold (Land Registration) Rules, r 6(6).  
59 CLRA 2002, sch 1 para 7. The certificate must also confirm that the commonhold association has not traded and has not incurred any liability which has not been discharged.
Transitional period

6.6 Once the above documents have been provided, HM Land Registry should register the land as a freehold estate in commonhold. The applicant will be registered as the freehold owner of the common parts and units\(^6^0\) and will remain so, until the first unit is sold to a unit owner.\(^6^1\) The period between the registration of the freehold estate in commonhold and the sale of the first unit is referred to in the 2002 Act as the “transitional period”.\(^6^2\) Whilst the 2002 Act provides for regulations to be made which modify the effect of the 2002 Act, the CCS or Articles during the transitional period, it appears that no such regulations have been created.\(^6^3\)

6.7 Once the first unit has been sold, the transitional period will come to an end and:

(1) the commonhold association will be registered as the freehold owner of the common parts of the commonhold instead of the developer;\(^6^4\)

(2) the rights and duties set out in the CCS will come into force;\(^6^5\)

(3) any leases, of any term, whether over the whole or part of the commonhold land, will be extinguished;\(^6^6\)

(4) any charge over the whole or part of the common parts will be extinguished;\(^6^7\)

(5) any charge over part only of a commonhold unit will be extinguished;\(^6^8\) and

(6) the applicant will remain the registered owner of any unsold units.

6.8 Until the CCS comes into effect and the commonhold association becomes entitled to be registered as the owner of the common parts (in other words, until the end of any transitional period), the developer will be the registered owner of all the commonhold

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\(^6^0\) Each of which will have their own registered title number, see G Cowen, J Driscoll and L Target, *Commonhold Law and Practice* (1\(^{st}\) ed 2005) para 4.5.

\(^6^1\) CLRA 2002, s 7(2)(a).

\(^6^2\) CLRA 2002, s 8. Reference to the “sale” of a unit is to the point at which a person other than the applicant becomes entitled to be registered as the proprietor of the freehold estate in one or more (but not all) of the commonhold units (CLRA 2002, Pt 1, s 7(3). If the developer sells all of the site to a different developer or other third party this sale will therefore not put an end to the transitional period (G Cowen, J Driscoll and L Target, *Commonhold Law and Practice* (1\(^{st}\) ed 2005) para 4.8.1).

\(^6^3\) CLRA 2002, s 8(2) and (3).

\(^6^4\) CLRA 2002, s 7(3)(a) and (b).

\(^6^5\) CLRA 2002, s 7(3)(c).

\(^6^6\) CLRA 2002, s 7(3) and (4). This applies to leases granted before the commonhold association became entitled to be registered as the owner of the common parts.

\(^6^7\) To the extent that it relates to the common parts: CLRA 2002, s 28(3). G Cowen, J Driscoll and L Target, *Commonhold Law and Practice* (1\(^{st}\) ed 2005) para 2.3 states that the charge will transfer to any unsold unit titles and that those lending on commonhold will, in the usual way “agree to a discharge of their mortgage over an individual unit when it is sold on part payment of the loan”.

\(^6^8\) CLRA 2002, s 22(3) and (4).
land and will have a great deal of flexibility to vary the extent of the commonhold land, the provisions of the CCS and Articles.\textsuperscript{69}

After the transitional period

6.9 After the transitional period has ended, the flexibility available to developers can be significantly limited by provisions of the 2002 Act and the CCS which come into effect. For example, unit owners’ consent is required to make certain changes, such as a change in the boundaries of a unit, or changing rights over a limited use area.\textsuperscript{70} The developer may therefore wish to reserve development rights to facilitate the completion of the development and to vary the extent of the commonhold land after the transitional period.

Rights which may be reserved

6.10 The rights which may be reserved are listed in the 2002 Act.\textsuperscript{71} These rights permit or facilitate the developer to:

1. complete or execute works on the commonhold land (or land which may have been added to the commonhold under the separate development right below);
2. advertise and carry out other activities designed to market the commonhold units;
3. add commonhold land;
4. remove commonhold land;\textsuperscript{72}
5. amend the CCS; and
6. appoint and remove directors of a commonhold association.

6.11 The CCS may also include obligations on the unit owners to co-operate with the developer in exercising these development rights and can specify the consequences of failing to do so.\textsuperscript{73}

Restrictions on the exercise of development rights

6.12 Where development rights are reserved, they must be set out expressly in a separate annex to the CCS, which must be the last annex.\textsuperscript{74} Reference to this annex must be included in the table of contents. These requirements mean that development rights

\textsuperscript{69} In order to retain maximum flexibility, it has been suggested that it would be sensible for developers to keep the transitional period as short as possible and only apply for registration when the first sales of planned units are imminent: see D Clarke, L Crabb and N Roberts, \textit{Clarke on Commonhold} (loose-leaf ed 2006) (referred to throughout this Consultation Paper as “\textit{Clarke on Commonhold}”), para 4[7].

\textsuperscript{70} See further ch 8, para 8.18 and fig 20.

\textsuperscript{71} CLRA 2002, sch 4.

\textsuperscript{72} Otherwise, there is no express power given to the commonhold association to remove land from the commonhold once the transitional period has ended.

\textsuperscript{73} CLRA 2002, s 58. Prof Clarke suggests that potential penalties could include the imposition of a financial penalty.

\textsuperscript{74} Commonhold Regulations 2004, reg 15(10).
always appear in the same place in the CCS and so can readily be identified. The annex can also then be removed easily when the development rights are no longer relevant.

6.13 The CCS may make the exercise of the development rights subject to certain terms and conditions. Additionally, the Commonhold Regulations place certain restrictions on a developer’s exercise of development rights in order to protect unit owners:

(1) the developer must not exercise rights in a way which would interfere unreasonably with unit owners’ enjoyment of their units or their ability to exercise rights granted by the CCS;

(2) the developer may not remove land from the commonhold which forms part of a unit unless the owner of that unit provides written consent;

(3) any damage caused to the commonhold land by the developer should be remedied as soon as reasonably practicable; and

(4) the developer may not exercise development rights if the works for which the right was granted have been completed (excluding the developer’s right to market units).

6.14 Where a developer has reserved the right to appoint a director or directors in the CCS, there are restrictions on how many directors may be appointed, depending on how many units have been sold.\(^{75}\) The position is summarised below.

(1) *While the developer retains ownership of at least one quarter of the units within the commonhold* (in other words, where 75% or fewer of the units have been sold): the developer can appoint up to one quarter of the directors of the commonhold association. These directors are referred to in the Commonhold Regulations as “developers’ directors”. If the unit owners vote to reduce the number of directors so that the one quarter limit is exceeded, the developer must reduce the number of developers’ directors accordingly.\(^{76}\) During this time, the developer will not be able to vote in any resolution to amend the number of directors of the association.\(^{77}\)

(2) *If the developer no longer owns one quarter of the units* (in other words, where more than 75% of the units have been sold): the developer will no longer be able to appoint directors and any developer’s directors already appointed will immediately cease to hold office.\(^{78}\)

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\(^{75}\) Note that during the transitional period, the developer may appoint up to two directors in addition to any directors appointed by the subscribers to the memorandum of association.

\(^{76}\) Commonhold Regulations 2004, reg 14(8)(b) and (e).

\(^{77}\) Commonhold Regulations 2004, reg 14(h).

\(^{78}\) Commonhold Regulations 2004, reg 14(8)(f).
Transfer of development rights

6.15 The development rights may be transferred to another developer at the time all or part of the development is sold. This transfer of rights is referred to in the 2002 Act as “succession”.

6.16 If the transfer of the whole or part of the commonhold land takes place during the transitional period, the new developer will be automatically treated as the “developer”. The new developer will therefore be entitled to exercise the development rights reserved in the CCS.

6.17 If, however, the transfer takes place after the end of the transitional period, it will be necessary for the transfer expressly to state that the development rights are being transferred. Furthermore, it will only be possible to transfer development rights after the end of the transitional period where more than one unit is being transferred to the new developer.

Termination of development rights

6.18 As explained above, aside from the right to market units, the developer may not exercise development rights if the works for which the right was granted have been completed.

6.19 A developer may end any development right by sending a notice to HM Land Registry surrendering this right.

6.20 The CCS may contain conditions attached to the exercise of development rights such as an “end stop” date after which the rights will expire. As the authors of Clarke on Commonhold point out, such a condition could be used to prevent the developer retaining ownership of one or more units as letting investments, and thus being able to exercise development rights indefinitely.

Flexibility provided in leasehold developments

6.21 When considering whether to build new commonhold developments, developers are likely to look at whether commonhold offers a comparable level of flexibility to leasehold.

6.22 We understand that residential leasehold provides developers with a great deal of flexibility as to how they complete the development once the first properties have been

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79 CLRA 2002, s 59.
80 In the case of a transfer of part this will be so far as the rights relate to the part that is transferred.
81 CLRA 2002, ss 59(1), (2) and (3). Prof Clarke also raises the potential obstacle that, due to a lack of clarity in the wording of the Act, a transfer of part to another developer may trigger the end of the transitional period, which may not be intentional or desirable: see Clarke on Commonhold, para 8[28].
82 Clarke on Commonhold, para 8[29].
83 Commonhold Regulations 2004, reg 18(5).
84 CLRA 2002, s 58(6). The right will end once the notice has been registered. HM Land Registry is required to inform the commonhold association as soon as reasonably practicable.
85 Clarke on Commonhold, para 8[34].
sold. For instance, the lease may reserve the right for developers to add land to the common parts at a later date or build on adjoining land.  

6.23 Usually, the cost of providing services to leaseholders is recovered through a service charge, which, in more complex developments, may consist of various components. Typically, different elements of the service charge might relate to:

(1) costs relating to the repair, insurance and maintenance of the building in which the leaseholder’s flat is situated;

(2) costs relating to the parking areas and gardens or other amenity areas benefiting the building and other buildings in the immediate vicinity; and

(3) costs – including the cost of providing estate roads, leisure amenities, and security staff – relating to the entire estate of which the building forms part.

6.24 Further, leases may include a provision which permits the landlord to add to, or vary, the services which the leaseholders will be responsible for paying for. For example, if a subsequent phase includes a fitness suite, which leaseholders become able to use, the landlord may seek to recover additional running costs connected with that. Usually, a landlord will need to point to an express term of the lease which allows costs relating to a particular service to be recovered. We understand that certain leases may include a provision that the landlord can provide and charge for additional services if a majority of leaseholders agree.

6.25 Developers can also retain flexibility in the way costs are shared between leaseholders. Rather than setting a fixed percentage at the outset, the lease may require the leaseholder to pay a “reasonable contribution” towards the cost of providing services. Therefore, where a developer wishes to add, or remove, flats from a particular phase, it can do so and increase or decrease a leaseholder’s percentage contribution without needing to amend the terms of the lease. The existence of multiple elements to the service charge (as described in paragraph 6.23 above) means that the proportion of the “estate-wide” costs payable by an individual leaseholder can also be varied, without the need to alter the proportion of the charge covering costs incurred within the building.

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86 We understand that such arrangements can operate informally, with leaseholders purchasing a flat on an understanding that facilities will be added in later phases of a development.

87 A service charge is a charge payable by the leaseholders under the terms of the lease to cover the cost of services provided by the landlord or a management company. Typically these include matters such as the repair and maintenance of the common parts, the insurance of the buildings, and the upkeep of any garden and parking areas.

88 We have gained the impression that provisions such as these are most commonly encountered in sheltered accommodation and other developments intended for those over retirement age.

89 Often, the lease will require the developer’s surveyor to determine what contribution would be reasonable. There is case law to the effect that a provision such as this would be reviewable on an application being made under the Landlord and Tenant Act 1985, s 27A to the Tribunal. This is on the basis that, if the determination is expressed to be conclusive, and to oust the jurisdiction of the court or Tribunal, it is in breach of s 27A(6): Windermere Marina Village Ltd v Wild [2014] UKUT 163 (LC), [2014] 3 Estates Gazette Law Reports 12 (approved by the Court of Appeal in Sheffield City Council v Oliver [2017] EWCA Civ 225, [2017] 1 WLR 4473).
6.26 In response to our Call for Evidence, a number of developers expressed concern that the current commonhold model does not provide a comparable level of flexibility to residential leasehold. At the same time, we are concerned that, in some areas, initial purchasers of commonhold units may be less well protected within commonhold than leasehold. We now consider the issues raised in more detail and set out provisional proposals for reform.

**CRITICISMS OF THE CURRENT LAW**

**The balance between developers and purchasers**

6.27 Our main concern with the current law is that development rights do not fit the purpose for which they were intended. To developers, they appear to limit flexibility, while at the same time for purchasers they do not provide certainty. It also seems to us that development rights were intended to cover smaller-scale developments, rather than today’s modern developments.90 The development rights provided for in the 2002 Act are considerably more flexible than are those in the Aldridge Report.91 However, they seem to cope better with minor revisions to the boundaries of a development, rather than the addition of substantial areas for future phases of the development.

Developers’ concerns for flexibility and control

6.28 Developers may feel that development rights limit their flexibility to complete the development, particularly as they can only reserve rights falling within an exhaustive list set out in the 2002 Act. The authors of *Clarke on Commonhold* argue that the fact development rights need to be reserved at the outset may be seen as a “limiting factor” when compared with leasehold.92 One respondent to our Call for Evidence agreed, saying:

> whilst there was initial enthusiasm for embracing commonhold … the requirement to register the land as commonhold and consider developers’ rights at the outset of the development unduly fettered developers’ flexibility to make changes during the course of construction and sale.93

6.29 Another felt that difficulties in changing the commonhold plan, once registered, were a disincentive: “layouts can change during the construction phase, and developers also sell off-plan”.94

6.30 Developers and their representatives seemed particularly concerned that commonhold, even with development rights, would not be suitable for some of the largest and most ambitious developments where the full extent of the development was not known when building commenced. An example would be where it was unclear which areas of land a

90 See ch 5, n 1.
91 The Aldridge Report attempted to deal with the issue of larger and more complex developments by providing for commonhold developments in up to four phases. Its proposals, and those in the 1990 and 1996 Draft Bills, are discussed briefly in Commonhold: Legislative History.
92 *Clarke on Commonhold*, para 8[1].
93 Irwin Mitchell LLP (solicitors).
94 Association of Retirement Housing Managers.
Government agency and/or a local authority would be willing to release. Such developments might extend over 20 years or more. It was suggested by one group representing developers and investors that “developers may be inclined to build simpler or smaller developments, in turn affecting the viability of the development and the amount of affordable housing which could be included”.95

6.31 There is also an assumption that in a leasehold development, a developer would have more freedom to complete further development or make changes to the estate: see further, paragraphs 6.24 and 6.25 above.

Protection for initial purchasers

6.32 On the other hand, some respondents expressed concern that development rights would be widely used and open to abuse.

Once new owners occupy more than 50% of the phase the developer effectively loses control of that phase, potentially to the detriment of the development, sales and marketing of the successive phases… the Developer would likely incorporate “developers’ rights” to overcome this and this opens the door for potential abuse.96

6.33 Similarly, some respondents to our Call for Evidence suggested that allowing developers to have too much flexibility does not serve consumers’ interests. As one commented, “developers have indicated that they want in practice more liberty not to deliver things that they have represented they will deliver - and in that respect a lack of flexibility would serve consumer protection and justice”.97

6.34 Equally, some commentators have argued that the current legislation is far too favourable to developers at the expense of initial purchasers. P F Smith argues that the risk of changes to the development lies with the initial purchasers in order to make commonhold more attractive to developers.98 This view is shared by C G van der Merwe.99 In many other jurisdictions, greater protection is given to unit owners.100 Other jurisdictions were not faced with having to set up a scheme to stand comparison with large scale, mixed-use developments, which have been developed on the basis of leasehold.

6.35 The need to reserve express development rights may, at first glance, appear to place purchasers of commonhold units in a better position than purchasers of flats in new leasehold developments. The authors of Clarke on Commonhold argue that a unit

95 The Leasehold Reform Group, a self-formed industry group. This group is an informal group of stakeholders in the UK housing market including Ground Rent Income Fund plc, HomeGround, Long Harbour, PGIM Real Estate and other institutional freeholders and freehold property managers.
96 Association of Residential Managing Agents.
97 Mr L Target.
100 For further information see Commonhold: Comparative Research, paras 2.19 and 2.26 (New South Wales); 3.10 to 3.13 (British Columbia); 4.32 (New Zealand); and 5.29 to 5.34 (USA).
owner will at least be able to see in advance which rights are being reserved, and would be able to raise enquires to reach an informed decision.\textsuperscript{101} However, this appearance of certainty is in fact limited in a number of ways.

1. There is no requirement for the developer to provide any specific details relating to the rights being reserved. Reserved rights can be expressed in very general terms. The authors of \textit{Clarke on Commonhold} suggest it would become "standard practice to reserve extensive development rights in a CCS".\textsuperscript{102} Lawyers acting for the purchasers may put pressure on developers to define any imprecise terms and seek assurances and a timescale for the completion of works. This approach would undermine commonhold’s objective of making conveyancing simpler and cheaper.

2. There is no guarantee that a developer could not add to the development rights after the first unit has been sold. The authors of \textit{Clarke on Commonhold} argue that whilst there is an assumption that a developer will set out all the rights in the CCS at the outset, there is no express provision which would prevent a developer from adding to these rights at a later date.\textsuperscript{103}

3. A developer may reserve the power to amend the CCS. This could involve amending important rights and obligations of unit owners as set out in the CCS. For example, the developer could make changes which affect voting rights, a unit owner’s use of a particular facility, or the commonhold contributions.

Additionally, although a developer may still require a resolution of members in order to amend the CCS, while the developer owns the majority of units within the development, he or she should be able to exercise the majority of voting rights of the commonhold association. The developers’ ability to do so rests on the assumption that the developer will be able to exercise the votes attached to all units of which he or she is the registered owner (in other words, which have not yet been sold). It has, however, been suggested that a possible interpretation of the 2002 Act is that under the “without unit owners” procedure, developers would only own one vote altogether, and not the total number of votes allocated to the units that they retain.\textsuperscript{104} To overcome this uncertainty, developers could use the registration procedure “with unit owners” intended for converting existing buildings to commonhold. Under the “with unit owners” procedure, the developer would be able to retain a controlling majority of the votes in the commonhold association so long as fewer than 50% of the units have been sold.\textsuperscript{105} Below, we make a provisional proposal to remove this ambiguity, and ensure developers, using either procedure, will be able to exercise the votes of all units they own. This approach reflects how commonhold is intended to operate – those who own more units have a greater say.

\textsuperscript{101} \textit{Clarke on Commonhold}, para 8[1].

\textsuperscript{102} \textit{Clarke on Commonhold}, para 8[4].

\textsuperscript{103} \textit{Clarke on Commonhold}, para 8[7].

\textsuperscript{104} The argument is based on a possible interpretation of the CLRA 2002, sch 3 paras 6(3) and 7, and the wording of what is now the Commonhold (Amendment) Regulations 2009 (SI 2009 No 2363), sch 3 art 30(b). The argument is set out in \textit{Clarke on Commonhold}, at para 11[10]. The authors think it more likely that, with registration under s 7, the developer would receive all the votes belonging to the units, but accept that there is an argument to the contrary.

\textsuperscript{105} Assuming each unit has an equal voting entitlement.
However, even after the requisite majority has been lost, the developer may still be able to ensure that votes of the association are passed in a way which supports the ongoing development. Control may be maintained by the developer in one of the following ways, to the detriment of unit owners’ certainty.

(1) The developer may include an obligation in the CCS requiring the unit owners to “co-operate” with the developer in exercising development rights. This obligation could extend to unit owners voting in support of changes to the CCS suggested by the developer. For example, a previous draft of the Commonhold Regulations required unit owners to:

co-operate with the developer for the purposes of amending the commonhold community statement in the event that land is added to or removed from the commonhold or the extent of a commonhold unit is redefined.106

(2) It has also been suggested that a developer may require new unit owners to sign an irrevocable power of attorney107 to enable developers to vote on unit owners’ behalf. Granting the developer a power of attorney has become a practice in other jurisdictions.108

The ability of developers to maintain control in these ways does not appear to have been intended by the commonhold legislation. In some cases, by taking these steps, a developer could have even more flexibility than in leasehold. In leasehold, a leaseholder has some degree of protection provided by the terms of his or her lease, which the developer would not be able to change unilaterally. For example, a lease may provide a leaseholder with certain rights over an area of land. If the developer sold any part of it, the sale would be subject to the rights enjoyed under the lease. However, in commonhold, the developer may be able to change the terms of the CCS unilaterally by retaining control of the commonhold (subject to any requirement to obtain the express consent of unit owners).109

Finally, the restriction on the number of directors which developers may appoint (see paragraph 6.14 above) only apply where developers have reserved this development right in the CCS. Where the developer has not made this reservation in the CCS the developer may be able to block the removal of directors put in place during the transitional period. This is because the developer should be able to retain control of the commonhold through ownership of unsold units or through the measures set out at

106 This provision would be included in the CCS automatically unless displaced by the developer. The draft regulations also provided that if unit owners did not co-operate in this way “a resolution of the commonhold association to amend the commonhold community statement will be deemed to have passed”.

107 A power of attorney is a legal document under which a person (known as “an attorney”) can be appointed to make decisions on behalf of another person.

108 Clarke on Commonhold, paras 8[25], 8[36] and 15[22], n 6.

109 For example, a unit owner’s specific consent would be required to change the boundaries of their unit or change their use of their property. These restrictions would also apply in leasehold. We are also make proposals in ch 8, para 8.61 which will enhance unit owners’ rights to challenge their allocation of the commonhold contribution.
paragraph 6.37 above. The developer may therefore be in a stronger position by not electing to reserve the right to appoint directors in the CCS.

PROPOSALS FOR REFORM

6.40 Facilitating the creation of new commonhold developments requires a careful balance to be struck between the flexibility provided to developers and the certainty provided to initial purchasers. We consider that development rights should meet the following objectives:

1. allow developers to build in phases, without necessarily being required to commit themselves at the outset to what the final extent of the development will be;
2. make it clear what elements the developer is committed to build, and which only may be built;
3. require all unit owners to contribute towards all facilities which benefit them;
4. permit the commonhold contributions to be split so that a unit pays, say, x% of the cost of providing services to the block of which it forms part (for example, repairs, maintenance, insurance, etc), and y% of the cost of providing services to the entire estate (for example, estate roads, estate security and flood defences);
5. ensure that those who benefit from a facility are entitled to vote on decisions which relate to it;
6. allow for a commonhold to grow, including by the addition of “sections”; and
7. provide for the developer to determine any necessary reallocation of contributions or votes, with a right to refer the allocation for independent scrutiny by the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal in Wales (“the Tribunal”) at the request of unit owners, so as to prevent unfairness.

6.41 We first consider how these objectives can be achieved, and make provisional proposals for reform.

A new scheme for development rights

6.42 We think that, under the current law of commonhold, a comparable level of flexibility to leasehold could be obtained. As discussed in paragraphs 6.4 to 6.20 above, a developer would be able to reserve the right to add or remove land and amend the provisions of the CCS, including the voting rights allocated to each unit owner, and the share of the commonhold contributions to be paid by each unit owner. The developer could include

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110 Although see the discussion of this at para 6.38 above. Registration “with unit owners” would appear to achieve this.

111 Clarke on Commonhold, para 8[25].

112 In ch 5, para 5.39 onwards, we provisionally propose the use of “sections” to separate out the management of commercial and residential elements of a development. Sections are a means of grouping different units within a commonhold in accordance with their particular interest, by effectively creating different membership classes within a single commonhold association.
a requirement in the CCS for the unit owners to co-operate by voting in favour of certain decisions or could go further and require each new unit owner to sign a power of attorney in favour of the developer, which would enable the developer to exercise all rights of the commonhold association.

6.43 However, we think this approach has three main drawbacks. First, the need to record development rights in the CCS at the outset is cumbersome and may deter developers from using commonhold. Further, it also places a heavy burden on the conveyancer acting for the first purchaser to assess whether the rights are appropriate, as once contracts have been exchanged on the sale of one unit, it will be more difficult to vary the development rights. There is no guarantee that the conveyancer who acts for the purchaser will necessarily identify important points.

6.44 Additionally, the way that developers are able to retain control may include “work-arounds” such as requiring unit owners to co-operate and requiring powers of attorney.

6.45 Finally, in certain cases, unit owners are provided with less certainty than in residential leasehold. Whilst the lease may set out certain protections which the developer would be unable to change unilaterally, the developer of a commonhold may reserve the right to change the CCS unilaterally, and significantly affect the rights of the unit owners.

Phasing proposals

6.46 We set out below how we envisage new commonhold developments could be phased in a way which meets developers’ legitimate needs.

6.47 The developer should not be required to register the whole development as commonhold at the outset. Instead, the developer should be able to build up the commonhold development in phases.

6.48 Once a particular building has been completed, before a developer transfers a unit in that building, the developer would need to register the building as commonhold. The developer could also register as commonhold any land intended for the common use of the unit owners within that building phase. However, as we go on to discuss, the developer would need to be willing to give up a certain degree of control over any land registered as commonhold within that phase, once a certain number of units have been sold. Therefore, a developer may prefer only to register the outline of the building (that is, the physical footprint of the building see figure 19, phase 1 below) and any amenity areas associated with the building (such as garages or a car park) as commonhold in the first instance.

6.49 Once the first unit in the building has been sold, the common parts within the first building phase would transfer to the commonhold association. For example, the developer might register the outline of the building, and the land which immediately relates to it as a commonhold. The commonhold association would then be registered as the owner of the structure and exterior of the building and internal common parts, and the land which immediately relates to it. The developer could provide the

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113 We refer specifically to the transfer, or completion, of the sale; not the entry into a contract for sale of a unit.

114 This is the land edged with a dotted line in Phase 1 in fig 19.
commonhold association and the unit owners with easements giving rights of entry and access over the larger area of land retained by the developer.\footnote{Easements are rights enjoyed by a landowner over another person’s land. A positive easement (such as a right of way) involves a landowner going onto or making use of something in or on a neighbour’s land, in a limited way.} Restrictive covenants and declarations in respect of rights to light could also be included.\footnote{Covenants are a type of contractual promise concerning land, some of which can be enforced against future owners of the land, rather than just against the person who made the promise. A restrictive covenant is one that restricts the use that an owner can make of his or her land. A right to light is an easement that gives a landowner the right to receive light through defined openings in buildings on his or her land.} Once the land over which the easements had been granted have been added to the commonhold, the easements, covenants and declarations would fall away.

6.50 The developer would stand to lose control of the building and any land which benefits only that phase once a sufficient number of units had been sold. We provisionally propose that the developer should not be able to take a power of attorney over any votes associated with any of the units, or require unit owners to “co-operate” by voting to support any decisions of the developer.

6.51 Instead, we think that the commonhold should operate as intended with each owner being entitled to the percentage voting rights set out in the CCS. We provisionally propose to clarify the current law, so that the developer will be able to exercise all voting rights associated with the unsold units. Whilst the developer owns the majority of the units, the developer would therefore still be able effectively to control decisions of the commonhold in the usual way. However, once the number of units held by the developer drops below 50% (in other words once more than 50% of the flats have been sold) the developer would lose control over that particular phase.

6.52 In many ways, therefore, registration without unit owners would be very similar to that “with unit owners”, used for converting existing buildings to commonhold (see paragraph 4.5). The main difference is that the procedure for new developments contains a transitional period, whereas the procedure for conversion does not. We invite consultees views on whether the transitional period has advantages or whether it would be preferable only to have one procedure for creating commonholds.

6.53 Under our phasing proposals the developer would not therefore need to reserve rights to carry out any development works on land falling outside of the phase registered as commonhold. The developer would remain the owner of all land surrounding the first phase, which the developer would be free to work on as it wishes.

6.54 Once the second and subsequent phases are completed, these phases could be added to the first phase. Any common parts included within the subsequent phases would merge and would fall within the ownership of the commonhold association.
Taking a simplistic example, the developer wishes to build a residential development in two phases. The first phase includes a block of 5 flats with access to a garage and a car park.

After building phase 1, the developer registers phase 1 as a commonhold. The area of land included within the commonhold (shown outlined above) includes the outline of the building, the garages and car park. At this stage, the developer is still the registered owner of all the common parts of phase 1 and all the individual units.

On the sale of the first unit in phase 1 (flat 1), the common parts within phase 1 (that is, the common parts falling with the outlined area), are registered in the name of the commonhold association. The purchaser becomes the unit owner in respect of flat 1. In decisions of the commonhold association, the owner of flat 1 can exercise 20% of the votes of the association. The developer remains the unit owner in respect of the other 4 flats and can exercise 80% of the votes of the commonhold. The developer would therefore retain control over the association and could, for example, appoint his or her own directors. The developer could not require the owner of flat 1 to sign a power of attorney allowing the developer to exercise his or her voting rights.

The developer would retain all the land falling outside of the commonhold which he or she would be free to develop. The developer grants the owner of flat 1 an easement over the driveway in order to access flat 1.

The developer then sells two more flats. The three unit owners would collectively now own 60% of the votes of the association, sufficient for most decisions of the commonhold to be carried. The unit owners could decide to replace the directors put in place by the developer.

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117 On the assumption that votes are shared equally in the development, which they may not be in practice.
The developer completes phase 2 of the development. The developer applies to extend the area of land falling within the commonhold to include phase 2 (shown outlined above). All the common parts within the development will fall within the ownership of one commonhold association. The developer could reserve access rights over the commonhold land (for example, to market the units) or as we suggest below, such rights may be provided automatically by statute. The developer could create separate sections for phases 1 and 2 so that only decisions which affect the particular phase can be voted on and paid for by those within the particular phase.

6.55 Rather than needing to reserve rights to add land to the commonhold in the CCS, the developer could be provided with a statutory right to add land to the common parts as subsequent phases are completed. The developer could also be given a statutory right to amend the terms of the CCS in the first phase, but solely to amend the percentage contributions of unit owners following the expansion of the commonhold. For example, the first phase may include a large garden. A second phase may be added to the first phase. The fixed commonhold contributions payable by the unit owners in the first phase would therefore be reduced to take into account that the cost of maintaining the shared gardens would now be split between more owners.

6.56 However, the commonhold contributions may also increase as phases of the development are completed. For example, a developer may register a commonhold which only includes the outline of a building. The next phase of the building might include a swimming pool. After the next phase has been completed, the land and
swimming pool would become part of the common parts of the commonhold. If owners in phase 1 are to be able to use the pool, the developer could increase the percentage to be contributed by members in phase 1 so that the cost is shared between owners in both phases. Alternatively, if the pool is only for the benefit of owners in phase 2, the developer could create a “section” for phase 2 and allocate the cost and responsibility for maintenance solely to the owners of phase 2 (see Chapter 5, paragraphs 5.39 onwards for an explanation of the use of sections).

6.57 Although the ability of the developer to increase contributions to take into account additional services could give rise to concern, this possibility already exists in leasehold (see paragraphs 6.24 and 6.25 above). Developers have told us that it would be unlikely that they would add facilities until the cost could viably be shared between the unit owners. It is more likely that the developer would wait until a sufficient number of units had been built before providing such facilities, to ensure it is a facility which may be comfortably afforded.

6.58 A unit owner already has the right to prevent their share of the commonhold contributions being altered if this would be to “allocate a significantly disproportionate percentage” of the commonhold contributions to his or her commonhold unit.118 Existing unit owners would have this right whenever the developer added land to the commonhold. Although the increase in contributions following the addition of land by the developer potentially leaves scope for dispute, in leasehold developments it is not uncommon for service charge proportions to be set by the developer or the developer’s surveyor. The limited amount of case law suggests that use of such provisions does not present significant difficulties in practice and, if disputes arise, the Tribunal can resolve them.119

6.59 We acknowledge, however, that the developer would need to lodge a revised CCS to reflect the amended commonhold contributions and voting contributions after each phase, which is not a requirement in leasehold.

6.60 Under the present law, developers have to decide whether to reserve development rights or not. We invite consultees’ views as to whether developers should automatically have a wide range of development rights, into which safeguards will be built. We think these rights could be placed on a statutory footing, so that they do no need specifically to be reserved. These rights would be drawn widely and would include matters which are likely to apply in all commonhold developments, for example to add land and to make consequential variations to commonhold contributions and voting rights and various rights of access.

6.61 In our view, developers should not be given a statutory right to appoint directors. Instead, developers’ ability to appoint directors should depend on the number of units which remain unsold and, consequently the amount of control the developer retains. So long as the developer retains more than 50% of the votes allocated to the units, the developer would be able to nominate all the directors. Once the purchasers control more than 50% of the votes, then they would be able to control the election of the directors.


6.62 We propose to retain the general restrictions on the exercise of statutory development rights set out in paragraph 6.13 above (for example, the exercise of the statutory rights must not cause unreasonable interference), but we would be grateful for consultees’ views on whether any further restrictions should be necessary. In particular, we would be grateful for consultees’ views on whether there should be a time limit on the exercise of the statutory rights, and if so, what this time limit should be.

6.63 To summarise, we therefore take the view that it ought to be possible for large scale complex developments to be accommodated in the commonhold system even if the precise area to be included in the commonhold has not been predetermined at the outset. We think that this ought to be feasible through a broad use of development rights, focussing on the ability of the developers to add incrementally to the commonhold. The approach that we envisage, would entail:

(1) the developer initially setting up the commonhold so as to include the first phase of the development, with supporting easements being granted if necessary, which would endure for the short or medium term;

(2) the developer then having a statutory power to add further pieces of land as and when building on them is completed;

(3) the developer having the power to make necessary amendments to the CCS so as to reallocate both votes and commonhold contributions; this reallocation would generally be done by the developer’s surveyor;

(4) the unit owners having the right to apply to the Tribunal to prevent a disproportionate allocation of either votes or liability for contributions;

(5) the commonhold being able to grow, including by the developer opting to set up “sections”\(^{120}\) so that the different phases could vote by classes in their different sections; and

(6) introducing anti-avoidance measures which would prevent developers from taking powers of attorney from unit owners to enable them to exercise more extensive control over the commonhold association or any of its sections. The same would apply to contractual provisions intended to require a unit owner to vote as directed by the developer.

6.64 In putting forward these proposals we have endeavoured to have in mind what currently happens in complex, multi-phase leasehold developments, and to propose similar procedures, with similar or better protections for unit owners. Although the developer will still clearly be able to decide on the course and extent of any development, we do not think that doing so needs to depend on the developer retaining the freehold reversion in all the phases, as currently happens with leasehold.

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\(^{120}\) See ch 5, para 5.39 onwards.
Consultation Question 25.
6.65 We invite consultees’ views as to whether statutory development rights should apply automatically so as to avoid the need to reserve express rights in the CCS.
6.66 We invite consultees’ views as to whether such statutory rights should be drawn widely to include all matters which are likely to apply in commonhold developments, including (but not limited to) the right to add land, to make consequential variations to commonhold contributions and voting rights, and rights of access.

Consultation Question 26.
6.67 We provisionally propose that there should be no specific statutory provisions for the appointment of developers’ directors. Instead, a developer’s ability to appoint directors should depend on the number of units it retains.

Do consultees agree?
6.68 We provisionally propose that developers should be able to exercise all voting rights associated with the units of which they are the registered owners.

Do consultees agree?

Consultation Question 27.
6.69 Currently, the Commonhold Regulations place certain restrictions on a developer’s exercise of development rights:

(1) the developer must not exercise rights in a way which would interfere unreasonably with unit owners’ enjoyment of their units or their ability to exercise rights granted by the CCS;

(2) the developer may not remove land from the commonhold which forms part of a unit unless the owner of that unit provides written consent;

(3) any damage caused to the commonhold land by the developer should be remedied as soon as reasonably practicable; and

(4) the developer may not exercise development rights if the works for which the right was granted have been completed (excluding the developer’s right to market units).

6.70 We invite consultees’ views as to whether any further restrictions should be introduced on the use of development rights: in particular, whether a time limit should be imposed on the exercise of these rights (and if so, what this time limit should be).
Consultation Question 28.
6.71 We provisionally propose that "anti-avoidance" provisions should be introduced to ensure that the developer does not attempt to secure a greater degree of control by:

1. taking powers of attorney from the purchasers (or seeking to control votes in any other way); or
2. attempting to control how unit owners vote by inserting terms in the purchase contracts.

Do consultees agree?

Consultation Question 29.
6.72 We invite consultees' views as to what advantages there are (if any) of the transitional period in the registration procedure for new commonhold developments.
Part IV: The commonhold association
Chapter 7: The commonhold association: its function and structure

INTRODUCTION

7.1 A common feature of commonhold and equivalent ownership models in other jurisdictions is that they need to have some form of association to represent the unit owners.¹ No one other than a unit owner is able to be a member of the association, and all unit owners are members. So far as we are aware, in all Commonwealth jurisdictions this owners’ association is always given “legal personality” – in other words, in the eyes of the law it exists as a legal person, separate from the members that make it up.

7.2 Under the 2002 Act, in England and Wales the body which represents the owners of the individual units is called the “commonhold association”. We use this term only when referring to the owners’ association provided for in the 2002 Act. The organisation fulfils several roles, including the examples set out below.

1) It represents the unit owners collectively in their dealings with the outside world. This role includes:
   (a) entering into contracts for the repair and maintenance of the building;
   (b) taking out various insurance policies;
   (c) employing cleaners and gardeners (or arranging contractors to provide these services); and also
   (d) contracting for more specialised services, such as broadcasting and internet services, entryphones and lift maintenance.
   (e) most commonhold associations, except perhaps for the smaller ones, will in practice choose to engage a firm of managing agents, to whom day-to-day responsibility for most of these functions will be delegated. Some of the smaller associations, and a few of the larger ones, may decide that a director, or a group of directors, will act as manager.

2) It owns and is responsible for the common parts, and may therefore, for example, be liable to visitors if they are injured while in the common parts, in circumstances where the commonhold association is held to be negligent.²

¹ C G van der Merwe, a leading commentator on the law of apartment ownership, has expressed the view that a “properly structured organisation” to exercise managerial responsibilities is necessary for any scheme of apartment ownership to function effectively: “Apartment Ownership” (1994), in International Encyclopaedia of Comparative Law vol VI, para 332. It may be noted that Scotland has introduced the concept of the Development Management Scheme to make up for the shortcomings of the existing Tenant Management Scheme: see Commonhold: Comparative Research, paras 6.10 to 6.73.

² This is discussed further at para 7.14.
(3) It represents the unit owners collectively in their dealings with individual owners. The association will, therefore:

(a) set and collect the commonhold contributions – the amount that needs to be collected from the individual unit owners to meet the cost required to maintain, repair and insure the commonhold, and meet all its other expenses; and

(b) ensure that each unit owner observes their obligations under the commonhold community statement (“CCS”). These rules may sometimes deal with issues on which feelings can run high, such as noise nuisance, whether a unit may be used for business purposes (including Airbnb lettings), or the keeping of pets.

(4) The commonhold association will also be the forum within which the unit owners take decisions on behalf of the commonhold as a whole. For example, the association will:

(a) elect the persons who run the association (under the 2002 Act these are known as the directors); and

(b) decide whether the local rules of the CCS need to be added to or amended.3

7.3 Although it has been stated that the commonhold association will have to make certain decisions, in fact, under the 2002 Act, decisions will generally be made by the directors of the association. Only certain decisions are reserved for the members of the association, acting collectively.

THE CURRENT LAW

The basic structure of the commonhold association

7.4 The 2002 Act provides that the commonhold association must take the form of a company limited by guarantee, registered under what is now the Companies Act 2006. The association is therefore a company essentially like any other, and is subject to ordinary company law.

7.5 Most companies are “limited by shares”, which means, in effect, that each share represents a percentage of the value of the company. The total number of shares that an individual shareholder owns determines their total stake in the company. This form is mainly used for companies which are engaged in some commercial activity. It is also adopted by some Freehold Management Companies (“FMCs”): a company where the leaseholders in a block of flats own the shares in a company that owns the freehold of the building.

7.6 With a company limited by guarantee, on the other hand, there are no shares as such. The company has members who generally have an equal claim to the company’s assets. Companies limited by guarantee are widely used as non-trading companies,

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3 “Local rules” are explained in ch 8, at para 8.9 onwards, and in the Glossary.
including by some professional associations, and by campaigning groups. It is also the form adopted by some FMCs and is the form that must be adopted by Right to Manage Companies (“RTMCos”).

7.7 Like any limited company, a commonhold association must have a constitution. A company’s constitution is known as its “articles of association” (“the Articles”). Generally a company is free to frame its Articles however it wishes, provided that it observes certain basic requirements of company law. The form that the Articles of a commonhold association must take is, however, prescribed by regulations made under the 2002 Act. A noteworthy feature of these prescribed Articles is that (with certain exceptions when the association is being set up) only a unit owner may be a member of the company, and all unit owners must be members of the company (although membership is not automatic). These membership requirements are designed to ensure that all those who own a unit within a commonhold are members of the commonhold association, but that no one else can be a member and so influence how it operates.

7.8 Although companies limited by guarantee are generally set up on the principle of “one person, one vote”, they do not have to be so. The prescribed Articles for commonhold associations provide that each member will have the number of votes given to the unit in the CCS. Provisions of this kind are not commonly found with companies limited by guarantee, but the prescribed Articles are worded in this way so that voting rights can be varied where some units in the commonhold are larger than others. Larger units may also be required to pay a larger share of the commonhold contributions. It also means that members who own more than one unit can cast the total number of votes allocated to their units.

7.9 Apart from the fact that the voting rights will be determined by the CCS, the Articles of a commonhold association will follow the prescribed Articles. The intention is that anyone who buys a unit in a commonhold, or is advising someone who intends to do so, will know that the Articles are appropriate for their purpose. The prescription of the Articles of commonhold associations therefore provides a level of consistency between commonholds that is not found in leasehold. There is limited scope to amend the prescribed Articles. It is possible to add to the Articles – additions form part of the local

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4 For many years a model table of articles has been issued under the various Companies Acts: https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies. Those who set up a company have the choice of adopting the model articles as they are, of adopting them with amendments and additions, or drafting their own articles, as they see fit.

5 Commonhold Regulations 2004, as amended by the Commonhold (Amendment) Regulations 2009, SI 2009 No 2363 (“Commonhold Amendment Regulations”), to take account of the reduced role of the Memorandum of Association under the Companies Act 2006. The form that the Articles must take is set out in the Commonhold Regulations 2004, sch 2 (as substituted by the Commonhold Amendment Regulations).

6 The general requirement under the Companies Act 2006, s 112(2) that consent has to be given to become a member of a company is disapplied by the CLRA 2002, sch 3 paras 11 and 15(2). Membership is not technically automatic, in view of the provisions of the Commonhold Regulations 2004, sch 3 art 4.

7 There is no requirement that the voting rights should exactly correspond to the share of the commonhold contributions that is payable. It would be possible, for example, for contributions to be calculated strictly in accordance with floor area, but for a more “broad brush” approach to be adopted for voting rights.

8 Commonhold Regulations 2004, regs 14(3) to (9) (as amended by the Commonhold Amendment Regulations).
rules of the commonhold – but additions must be clearly indicated.  

9. Apart from these permitted amendments and additions, no derogations from the prescribed Articles are permitted, and they take effect whether or not adopted.  

10. As the prescribed Articles are contained in regulations made under the 2002 Act, any amendment to those Articles requires secondary legislation. As the Articles must be adopted, any amendments take effect for every commonhold association, whether or not an individual association takes steps to amend its Articles. As a result, all commonhold associations operate under the same prescribed Articles.

7.10 As the prescribed Articles are contained in regulations made under the 2002 Act, any amendment to those Articles requires secondary legislation. As the Articles must be adopted, any amendments take effect for every commonhold association, whether or not an individual association takes steps to amend its Articles. As a result, all commonhold associations operate under the same prescribed Articles.

7.11 In general, the commonhold association is subject to the ordinary rules of company law. As such, a decision may generally be made by passing an ordinary resolution: a resolution having the support of more than half the members present and voting at a general meeting. Certain company law matters – in particular the amendment of the Articles – requires a special resolution: a resolution passed by a majority of not less than 75% of those present and voting.  

12. Alternatively, members may make use of the written resolution procedure. This procedure requires the requisite majority of members either to sign a document setting out the resolution; or to sign identical documents. In the case of a written resolution the same majorities apply (over 50%, or at least 75%), but the majority must be of all those entitled to vote rather than those who do in fact vote. To take account of the special circumstances of the commonhold association, some decisions require higher majorities.  

13. It is also possible for the CCS to require that certain provisions in it can be amended with some majority other than a bare majority.

7.12 Each commonhold association must have at least two directors, but there is no maximum number, unless one is stated in the Articles. A director need not be a member of the association. Therefore, if it is not possible to find members of the association to serve as directors, an association may appoint, say, partners or directors in a firm or company of managing agents as the directors, and/or a solicitor or accountant, on the basis that they will be remunerated. Managing agents who are directors would ultimately be answerable to the members of the commonhold

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11. In person or by proxy.
12. Although for convenience this paragraph refers to “those present and voting” or “eligible to vote”, it should be noted that, if members have differential votes, the majority, or a three-fourths majority, is of the available votes, not of the relevant number of members.
13. These are summarised in ch 8, at para 8.15 and in fig 20.
14. Commonhold Regulations 2004, sch 3, art 39, as amended by the Commonhold Amendment Regulations. The Commonhold Amendment Regulations insert a new schedule 2 (Articles of Association) in the Commonhold Regulations, but for convenience and ease of accessibility reference will be made to the Commonhold Amendment Regulations.
15. There is no such provision in the prescribed Articles, but the Commonhold Amendment Regulations, sch, art 47 implicitly suggests that a maximum could be included in the Articles, either in the original Articles, or if they should be amended to that effect.
16. Commonhold Amendment Regulations, sch, art 40. The general assumption behind the CLRA 2002 seems to be that members who are appointed as directors would serve without payment, though this is nowhere prescribed.
However, in practice, the members would not be able to supervise them as closely as would be possible if directors who were members or were professionals had appointed the managing agents. If members objected to having to pay their directors, then they would have to appoint directors from amongst themselves.

### The limited liability of the commonhold association

7.13 Whether a company has limited or unlimited liability is important in the event that the company becomes insolvent. If liability is unlimited, then all the members are jointly and severally liable\(^\text{18}\) for its debts. Owners of the units may therefore find that they lose their homes, as well as other assets (such as savings) to pay for the commonhold associations' debts. We are not aware of any commonhold associations that have become insolvent. Experience in other countries, however, suggests that their equivalents to the commonhold association can become subject to claims which either threaten their solvency (if liability is limited), or result in the unit owners incurring substantial liabilities (if liability is unlimited). A body which has unlimited liability cannot become insolvent, except in the unlikely event of all members being insolvent. If money is owed to a creditor, he or she can look to any of the members of the body for payment.

7.14 A threat to the solvency of the commonhold association may arise, for example, where the association is held liable in negligence for an injury suffered by a person while using common parts of the commonhold, and the association is uninsured or underinsured.\(^\text{19}\) Liability in negligence may arise because, in legal terms, the association is considered to be the occupier of the common parts and as such is responsible to those (such as residents and visitors) who use them. Additionally, a risk of insolvency may arise if the commonhold association becomes involved in other legal proceedings, for example against a contractor undertaking major works, or through a dispute with the owner of neighbouring land.

7.15 Clearly, the law should, as far possible, minimise the risk of a commonhold association becoming insolvent. We make provisional proposals in Chapter 9 at paragraphs 9.60 to 9.96 with this aim in mind. These include proposals for new requirements aimed at ensuring that the commonhold association has adequate insurance. If adopted, our provisional proposals should ensure that insolvency is a rare event. Even so, we do not think that the risk of insolvency is one which can or should be disregarded. Responses to our Call for Evidence suggest that the risk of insolvency is a real concern, and is a factor in some lenders not wishing to lend on commonhold units.

7.16 The intention of the 2002 Act was that the unit owners who would form the membership of the commonhold association should enjoy the fully-limited liability that a member of

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\(^{17}\) They will be answerable to the members at the general meeting.

\(^{18}\) "Joint and several liability" means that each member is liable in full for the debts. A creditor could therefore sue any of the members for the full amount, leaving it up to the member or members who were sued to obtain contributions from their fellow members.

any other limited company enjoys. Shareholders in a company limited by shares cannot generally be required to contribute anything if the company becomes insolvent and has to be wound-up. With a company limited by guarantee, the members are not required to pay anything for their initial membership of the company, but they can be called upon to contribute a specified sum in the event of the company being wound-up. This sum is generally a nominal one of £1. Under the 2002 Act the liability of the members is limited, and the contribution from each member has to be set at £1.

7.17 However, if a company has limited liability, the inevitable consequence is that provision has to be made for it to be wound-up if it becomes insolvent. A commercial enterprise which is wound-up will have to go out of business and cease trading; a membership organisation which has been registered at Companies House as a company limited by guarantee will have to cease to function, at least in that form. The problem with a commonhold association, however, is that it has to exist in order for the commonhold to function properly. If the association ceases to exist, then the common parts will no longer be owned by the commonhold. The commonhold units will remain in the ownership of the unit owners but, as there will no longer be an overarching commonhold association or CCS, they will have become, in effect, a group of “flying freeholds”. In other words, there would be no structure in place to manage the relationship between the separate but interdependent commonhold units. This result will cause practical difficulties for the unit owners – for example in respect of their ability to enforce the CCS – and will also make units difficult to sell.

7.18 The 2002 Act attempted to square this circle by providing that, if the commonhold association was wound-up because it was insolvent, any interested party should be able to apply to the court which was dealing with the insolvency for a “succession order”. That order permits a “successor association” to be set up and to step into the

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20 We refer to the liability of a commonhold association as “fully-limited” when the unit owners as members of the association cannot be directly or indirectly liable for its debts. (We disregard the liability to pay the nominal sum of £1 in the event of the insolvency of the association).

21 An exception to this is if shares are not “fully paid up”. A further exception is discussed in para 7.32 below. When we refer to a company being “wound-up” or “liquidated” we mean that its assets are turned into cash, debts which are owed to it are recovered, and its debts are paid, so far as funds permit. Anything left over is divided among its members. The company then ceases to exist and is struck off the register of companies at Companies House.

22 Commonhold Amendment Regulations, sch, art 5.

23 Commonhold Amendment Regulations, sch, art 6.

24 See ch 5, para 5.18.

25 It is sometimes assumed that, if a commonhold association is wound-up without there being a “successor association” (see para 7.18 below) then there is nothing the owners of the (former) units can do to remedy the situation. It would, however, seem possible for them collectively to purchase the freehold of the common parts from the Crown. This is similar to the situation where leaseholders “buy back” the freehold reversion from the Crown after an FMC has been wound-up (see para 7.35 below). They could then “re-constitute” the commonhold. This would involve registering a new commonhold association at Companies House, and then registering a new commonhold “with unit holders” at HM Land Registry under CLRA 2002, s 9. The original CCS could be followed when drafting the new one.

26 CLRA 2002, s 51. The application can technically be made by the insolvent association, one or more members of the insolvent association, or the provisional liquidator of the insolvent association. Arguably the proprietor of a legal charge over a unit should also have standing here, as the value of its security would be
shoes of the insolvent association. The 2002 Act expressly says that there shall be a succession order unless the court "thinks that the circumstances of the insolvent commonhold association make a succession order inappropriate". Commentators differ on the implications of this presumption. Some stress that the making of a succession order – and without making any conditions – should be seen to be the norm. Others have noted that a succession order may include "supplemental or incidental provisions", and have suggested that these might extend to requiring the successor association to meet all or part of the debts of the insolvent one. The law is ambiguous as to whether the express presumption in favour of there being a succession order extends to one being made without conditions. Indeed, it is difficult to see the point of having a succession order procedure if it will generally be conditional upon meeting the debts of the previous association. The successor association would start life saddled with the debts of the previous association. It would be insolvent – in the sense that its debts exceeded its assets – and would be at risk of being wound-up again.

7.19 In a sense the current law is incomplete. There is scope in the 2002 Act for commonhold insolvency rules to be made to supplement the provisions for insolvency in the 2002 Act and the Insolvency Act 1986, but no such rules have ever been made. Parliament’s intentions here have not been made clear, and there is a need to clarify when a succession order should be granted, and when it might be appropriate to impose conditions, particularly provisions as to clearing or contributing towards the debts of the insolvent association.

CRITICISMS OF THE CURRENT LAW

7.20 We are proceeding with this consultation on the basis that it has been demonstrated that there is a need for some form of corporate structure to carry out the functions which we have set out at paragraph 7.2 above. We are, however, aware from the response to our Call for Evidence that respondents do have a number of concerns with the current law.

Is the company law model appropriate?

7.21 A number of respondents to our Call for Evidence suggested to us that it was unnecessarily complicated for the commonhold association to be a company governed

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27 CLRA 2002, s 51(4).
28 G Fetherstonhaugh, M Sefton and E Peters, Commonhold (2004) takes the view (at 5.4.5) that it is difficult to see when it would not be appropriate to grant a succession order. The implication seems to be that it would not be usual to impose conditions.
29 CLRA, s 52(4(d)).
30 Clarke on Commonhold seems to take this view at 22[21]: "It is suggested, therefore, that it would be inappropriate to make a succession order unless the unit-holders have, via additional [contributions], provided for the payment of creditors in full." G Cowen, J Driscoll and L Target, Commonhold: Law and Practice (2004) also assumes (at 15.5) that a succession order would not be granted unless the unit-holders were willing to meet the debts of the insolvent association.
31 The Department for Constitutional Affairs issued a Consultation on Termination of a Commonhold in September 2003, but no rules were ever made.
by the Companies Acts, and urged that some bespoke, simpler structure should be devised. We recognise the strength of this view, but:

(1) In order to provide a bespoke structure, a considerable amount of the detail covered in the Companies Acts would have to be covered in the commonhold legislation. It is unlikely that the legislation could cover every contingency, and company law may remain a logical analogy. Some respondents therefore felt that it was preferable to take company law as the starting point and make such alterations to it as seemed necessary and appropriate.

(2) Other respondents suggested that a company limited by guarantee was as good a structure as any, and has the advantage that all lawyers and many members of the public are familiar with the concept of a limited company.

(3) Many of the criticisms of company law involved issues such as:

(a) the difficulty in recruiting directors;
(b) the need to make annual “confirmation statements”\(^\text{32}\) to Companies House; and
(c) the risk of companies being struck off for failure to make returns.

7.22 It is not apparent that the use of a bespoke body would address these difficulties. A formal structure of some kind will be necessary regardless of the nature of that body. Creating a bespoke body does not resolve the key issue of whether there should be limited or unlimited liability.

7.23 In view of these factors, we are not persuaded that abandoning the use of company law for the commonhold association will assist in the reinvigoration of commonhold.

**Should the company be registered under the Companies Acts or under some other provision?**

7.24 Although the choice was made in the 2002 Act to have the commonhold association take the form of a company limited by guarantee, incorporation under the Companies Acts was not the only option. It could have been incorporated instead under what is now the Co-operative and Community Benefit Societies Act 2014 (the 2014 Act), which has the superficial advantage that the structure is intended for ‘not for profit’ companies, which would include commonhold associations.\(^\text{33}\) We note, however, that the vast majority of leaseholder-controlled companies\(^\text{34}\) appear to have adopted the company law model, rather than registering under the 2014 Act or its predecessors. We also understand that knowledge of the law relating to bodies registered under the 2014 Act tends to be confined to the small number of solicitors who specialise in the field. No respondents to the Call for Evidence suggested that it would be preferable for commonhold associations to be registered under the 2014 Act. We see no good reason to provide for incorporation under the 2014 Act rather than the Companies Act 2006.

\(^{32}\) These were formerly known as “annual returns”.

\(^{33}\) When the CLRA 2002 was passed, the corresponding act would have been the Industrial and Provident Societies Act 1965.

\(^{34}\) See Glossary.
Should the company be a company limited by shares or a company limited by guarantee?

7.25 If the commonhold association is to be incorporated under what is now the Companies Act 2006, the question arises whether it should be registered as a company limited by shares, or a company limited by guarantee. In certain respects, there is no significant difference between the two.

(1) Both provide limited liability which is “fully-limited”.\(^{35}\) In the case of the insolvency of a company limited by guarantee, each member agrees to contribute a nominal sum. In the case of a commonhold association, this sum is £1. A member of a company limited by shares has to contribute on its insolvency only if the shares are not fully paid up.\(^{36}\)

(2) Both allow votes to be allocated to members either equally, or on a differential basis.\(^{37}\)

(3) Both may also allow a member who owns more than one unit to exercise all the votes allocated to those units.\(^{38}\)

(4) Both could make provision to distribute profits to members. It would not generally be appropriate for a commonhold to do so, as most commonholds do not make profits from commercial activities, and those that do (for example, by lettings of leisure facilities) could use them to reduce their commonhold contributions. Occasionally, however, a commonhold association might sell off part of its grounds, and raise a sum of money which it is more appropriate to distribute to its members.\(^{39}\)

7.26 A company limited by shares has the advantage that it is more familiar to the public and to lawyers through experience of trading companies. This may, however, be less of an advantage than previously: experience of RTMCos\(^{40}\) should mean that the company limited by guarantee is becoming more familiar to lawyers, particularly those involved with leasehold conveyancing.

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\(^{35}\) As defined in n 200 above.

\(^{36}\) It is rare for shares not to be “fully paid up”. It means that they have been issued on the basis that only part of what is stated to be their “nominal value” has been paid. The company is then entitled to call for the remainder of the sum stated to be their “nominal value” if the company should need the funds. This would include that the funds were needed by the liquidator when the company was insolvent.

\(^{37}\) Practitioners often use a company limited by shares to set up an FMC if it is intended that flats of different sizes should be entitled to different numbers of shares. The CLRA 2002 and the Commonhold Regulations 2004 illustrate that this is also possible with a company limited by guarantee.

\(^{38}\) This is generally the automatic result with a company limited by shares, but, again, it is possible with a company limited by guarantee.

\(^{39}\) This is not currently possible, but this is because of a provision of the law on commonhold (Commonhold Amendment Regulations, sch, art 72), and not because it is a company limited by guarantee (Palmer’s Company Law (loose-leaf ed 2018) 2.014; M Mullen and J Lewison Companies Limited by Guarantee (4th ed 2013) at 3.3.1). The prescribed Articles could therefore be amended, if it were thought desirable. As making a distribution to members would rarely be needed, and would be open to abuse, it might be permitted only with the permission of the court.

\(^{40}\) See Glossary.
7.27 The use of a company limited by guarantee is likely to be administratively more convenient for the directors. In particular, there is no need to issue share certificates to the members. The difficulties are illustrated by the experience of those Residents' Management Companies (“RMCs”) which have been set up as companies limited by shares. With an RMC, the owners of leasehold flats also own between them the company which manages the building. Similar considerations apply to FMCs, where the leaseholders’ company owns the freehold of the building. When someone sells their leasehold flat, they should also sell their share in the company, and sign a form to transfer their share in the company to the buyer. The buyer will then send the old share certificate and the transfer form to the directors of the RMC, who will cancel the old certificate, and issue a new share certificate to the buyer. Problems can ensue if the buyer or seller does not follow this procedure. It can be difficult to comply if the flat is sold by the present owner’s mortgage company, as the lender will not always be able to transfer the share. Various workarounds can ensure that any difficulties can be overcome, but the position is more straightforward with a company limited by guarantee because memberships are not transferred: instead they are terminated and granted. The Articles can then provide that, if someone ceases to own a flat, the directors can simply remove their name from the members’ register, and accept an application for membership from the new owner.

7.28 Some respondents to our Call for Evidence suggested that some of the requirements generally imposed on companies by company law should be relaxed for RMCs and for FMCs. The requirements to make an annual confirmation statement, and to file accounts, were most frequently mentioned. Some suggested that these requirements could be relaxed for commonhold associations. Other respondents observed that most FMCs and RMCs would be classed by Companies House as micro-entities, and would therefore be subject only to the lowest level requirements. These respondents felt that such requirements were not onerous, and should be kept to ensure that directors were complying with their obligations. In our Consultation Paper on leasehold enfranchisement we ask whether any of the requirements of company law should be relaxed in respect of nominee purchaser companies on a collective enfranchisement. Similarly, in relation to commonhold, we are consulting on whether any requirements of company law could appropriately be relaxed for commonhold associations.

7.29 We take the provisional view, therefore, that, using an existing vehicle is likely to be preferable to setting up a bespoke one. Registration under the Companies Act is likely to be preferable to registration under any other corporate structure, and the company limited by guarantee would appear to be slightly preferable to the company limited by shares; and that some minor amendments could remedy some of the perceived shortcomings in the current provisions.

Has limited liability in fact been delivered?

7.30 As stated above, the intention of the 2002 Act was that unit owners within a commonhold should enjoy the same fully-limited liability as would generally apply to

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41 Similar considerations apply to FMCs, where the leaseholders’ company owns the freehold of the building.

42 We use this term where, broadly speaking, a company which is substantially controlled by the leaseholders owns the freehold reversion of their building.

43 Enfranchisement Consultation Paper, para 6.68.

44 Eg the Co-operative and Community Benefit Societies Act 2014.
members of limited companies. Soon after the Act was passed, however, several commentators questioned whether fully-limited liability had in fact been delivered.

7.31 It seems clear that the assumption of the 2002 Act was that a succession order should be granted virtually as a matter of course, permitting a successor association to step into the shoes of the insolvent association. Attention has, however, already been drawn to the uncertainty as to whether a succession order should normally be granted without conditions requiring the successor association to clear all or part of the debts of the insolvent association. Uncertainty over this point has led some to question whether limited liability has in fact been delivered.

7.32 There is clearly a breach in limited liability if, as a condition of granting the application to set up a successor association, the court imposes a requirement for the successor association to clear all or part of its predecessor’s debts. At least one commentator has pointed out that there may also be a further problem. In addition, the unit owners will remain members of the old commonhold association until the winding-up has been completed. The liquidator could therefore continue to demand contributions from the members in their capacity of members of the association, rather than as unit owners.

7.33 The limited liability of the unit owners would be undermined even further if the liquidator had made one round of demanding contributions from members, and some had been unable to pay. They might have been personally bankrupt, or it might be obvious that it was pointless to sue them. The liquidator might then issue a further round of demands to attempt to make up that shortfall.

7.34 The existence of FMCs will inevitably stand as a comparator to commonhold associations because of the FMC’s role in managing a block. The position of FMCs generally has not been widely explored either in case law, or in legal writing, but we put forward the following conclusions which would seem generally to be accepted as representing the law.

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47 The existence of FMCs was noted by L Crabb, “The Commonhold Association – As you like it” [1998] Conveyancer and Property Lawyer 283, but in her article “Commonhold Associations and their creditors” [2002] Insolvency Lawyer 204, she explicitly makes the comparison when considering the insolvency of the commonhold association. In a later article “The Commonhold and Leasehold Reform Act 2002: A company law perspective” [2004] Company Law 213 at 215, 216 she makes the point that members of what we are referring to as FMCs might also be subject to liability as members, though this seems unlikely for the reasons given in Appendix 5 at 5.3.

48 Our detailed analysis of the law on the insolvency of FMCs, and how it may be applied in practice, is set out in the Appendix 5.
Our tentative conclusions are that, if leaseholders own their freehold through the medium of an FMC, and it becomes insolvent:

1. they do not run any real risk of losing the equity in their homes, as they will retain the leases of their flats;

2. if the liquidator of the FMC were able to sell the freehold, they would be able to reacquire it by exercising the right of first refusal;\(^49\)

3. if the liquidator were unable to sell the freehold, they would be able to reacquire it from the Crown Estate;\(^50\)

4. in either case, the leaseholders would incur the cost of reacquisition, and the cost of setting up a new FMC, but there would be no question of having to meet the debts of the insolvent FMC;

5. the reserve funds of the former FMC would continue to be held on trust for the leaseholders;\(^51\) how far they were available to creditors would depend on the nature of their claims and the terms of the leases.

It must be borne in mind that limited liability protects the members of a company, but as a result those who are owed money by the company may lose out. Views may differ on how far the FMC model strikes an appropriate balance between its leaseholder-members, and the FMC’s creditors. Nevertheless, the existence of the current regime for FMCs is a fact, and many leaseholders do indirectly own their freeholds as a result of it.

We take the view that commonhold will offer leaseholders several significant advantages, even if they already own their freehold through an FMC: These advantages are set out in Chapter 1 at paragraph 1.33.

Our Call for Evidence suggests that it is rare for an FMC to become insolvent, though the possibility cannot be entirely disregarded. The position with commonhold associations is likely to be similar. Commonhold can appear to be less effective than “leasehold with an FMC”\(^52\) in giving unit owners the protection of limited liability. It appears to us likely to be rare for either a commonhold association or an FMC to become insolvent. It would be unfortunate, therefore, if any apparent disadvantage of commonhold to unit owners in this respect became the decisive factor in inhibiting the

\(^49\) Under the Landlord and Tenant Act 1987, Pt II, if a landlord wishes to sell the freehold to a block of flats, he or she must first offer to sell it for the same price to the leaseholders collectively. This is often called the “right of first refusal”.

\(^50\) If the liquidator appointed to wind-up the company was not able to sell the freehold, he or she would “disclaim” it under the Insolvency Act 1986, s 178. It would then pass to the Crown, as (in effect) land which did not have any other owner.

\(^51\) Under the LTA 1987, s 42. Under this section a landlord holds service charge funds on trust for the purposes set out in the lease, and (if that is no longer possible), then for the leaseholders. The trust continues to apply even when the funds are in the hands of someone else, such as the liquidator.

\(^52\) This is also sometimes called “enfranchised leasehold” as it follows a collective enfranchisement.
take up of commonhold, when it has advantages over “leasehold with an FMC”. But unless it is addressed, two consequences may follow.

(1) If commonhold and enfranchised leasehold are offered as alternatives, then some purchasers may be advised to avoid commonhold.

(2) Converting to commonhold may well be most practicable for those leaseholders who already own their own freehold through the medium of an FMC, as they will have experience of running a company, and there would be no freeholder to buy out. In spite of the advantages of converting to commonhold, the possible loss of fully-limited liability would be for many a disincentive.

7.39 In view of these factors, our provisional view is that, in order to be an attractive proposition, the commonhold association will need to offer unit owners a comparable degree of limited liability as is provided to leaseholders who own their freehold via an FMC. This policy is, however, easier said than done, as the position of the FMC will differ, dependent upon a number of variable factors. We have explained the position with regard to the limited liability of the FMC in Appendix 5 to this Consultation Paper. In Appendix 5 we compare what we consider are the respective positions of FMCs and commonholds on insolvency. Inevitably, some of the views in that analysis are speculative.

7.40 It has sometimes been suggested that the position of the unit owners within the commonhold association would be better protected if the reserve funds enjoyed trust status, comparable with that given to leaseholders’ service charge funds. We consider this point at paragraphs 7.64 to 7.66 below.

PROPOSALS FOR REFORM

7.41 As we have explained in paragraphs 7.21 to 7.29 above, our view is that the commonhold association should continue to be a company registered under the Companies Acts; that it should have limited liability; and that it should take the form of a company limited by guarantee. The commonhold association under the 2002 Act has been criticised on the basis that it does not offer fully-limited liability. We do not therefore consider that we could recommend its replacement with some other form of body which gives the unit owners unlimited liability, or some intermediate position.

7.42 There is a divergence of opinion among respondents to our Call for Evidence as to whether the requirements of company law relating to filing of accounts, and making an annual confirmation statement at Companies House should be retained. We therefore make no proposals on this point, but we invite consultees’ views.

53 See ch 1, para 1.33.
54 Under Landlord and Tenant Act 1987, s 42.
55 The criticisms are cited in nn 30, 45 and 49.
56 An intermediate position called “restricted liability” was proposed in the Aldridge Report, and the 1990 and 1996 draft Bills. Commonhold: A consultation paper (1990) Cm 1345, and accompanying draft Bill. Further details of it are to be found in Commonhold: Legislative History, paras 1.60 to 1.71.
7.43 We have explained that the commonhold association will need to offer unit owners a comparable degree of limited liability to that enjoyed by leaseholders who own their freehold via a FMC. We therefore examine some options for reform with two objectives in mind:

(1) to ensure that commonhold associations are as rarely as possible forced into insolvency proceedings; and

(2) to offer the members of a commonhold association a comparable level of security as would be enjoyed by members of an FMC.

7.44 We recognise that these proposals will not always put commonhold associations in as privileged a position as FMCs. In some cases, however, commonhold associations will be in a better position than FMCs, especially where an FMC has a particularly valuable reversion.57

Ensuring that insolvency occurs as rarely as possible

7.45 We wish to ensure that commonhold associations are as rarely as possible placed in the position where they face insolvency. We make provisional proposals elsewhere in this Consultation Paper with the policy in mind. We set out those provisional proposals briefly here. We consider that these proposals are likely to be more important in practice than any reforms that we propose to the procedure on the insolvency of a commonhold.

(1) We provisionally propose that it should be compulsory for a commonhold association to take out third-party liability insurance, up to a level to be prescribed by regulation. This requirement should minimise the possibility of a commonhold association becoming insolvent as a result of a claim that causes a catastrophic loss.58

(2) We wish to strengthen the provisions relating to reserve funds, to ensure that, so far as possible, commonholds are not faced with unexpectedly large bills for repairs which they cannot meet. We have made proposals to try to achieve that aim.59

(3) We make provisional proposals to make it easier for commonhold associations to enforce collection of the commonhold contributions, to make it less likely that they will face insolvency because of debts owed to them by unit owners.60

Reforms of the insolvency procedure

7.46 We turn now to reforms to the insolvency procedure. It needs to be recognised that it is likely to be impossible to transpose exactly the level of limited liability enjoyed by the members of an FMC to the different circumstances of the members of a commonhold

57 This is explained in more detail at para 7.46(1) below.
58 By a “catastrophic loss” claim we mean the sort of claim described at the beginning of para 7.14 above; examples from other countries were given in n 19. See also ch 9, paras 9.60 to 9.96.
59 See ch 10, beginning at para 10.60.
60 See ch 14, from para 14.45 onwards.
association. The difficulty in doing so arises because the precise position of the members of an FMC varies depending on several factors.\(^{61}\) We discuss the position of members of an FMC further in Appendix 5. The key point, however, is that the assets owned by the FMC are likely to be insubstantial.\(^ {62}\)

(1) The funds which actually belong to the FMC are likely to be small, often only the proceeds from ground rents, and fees charged for various permissions.

(2) The service charge funds,\(^ {63}\) though likely to be more substantial, will be held on trust for the purposes for which they have been collected, with any surplus belonging to the leaseholders and not to the FMC. Whether these are available for creditors may depend on the terms of the leases. In the case of a substantial claim for personal injuries, none of the service charge funds may be available.

(3) The value of the freehold reversion will vary very much from one development to another. It will depend on factors which include:

(a) the length of the terms remaining on the leases, and the amount of the ground rents; and

(b) whether it is feasible for a liquidator to sell off some facility, or part of the land, for development (including rooftop or airspace).

(4) The leaseholders would clearly retain the value reflected in the leases themselves, although the value may be reduced if any of the common parts are sold off.

What assets would be lost on the insolvency of the FMC, and how much they were worth, would clearly determine whether or not the members of the FMC were prepared to let it become insolvent if it were faced with substantial claims.

7.47 We are not suggesting that leaseholders, when setting up an FMC, carefully weigh these matters up. They just assume that they will enjoy fully-limited liability. If an FMC is faced with insolvency, the members are likely to make some calculation of whether it is better to attempt to keep the FMC alive, or to allow it to become insolvent. They may see little point in struggling to ensure that the FMC remains solvent, if they can eventually buy back the freehold from the Crown. The end result of this possibility is that the cost of reacquiring the freehold (including all incidental legal costs) may serve in practice as an informal cap on the liability of the FMC.

7.48 Because of these variables it is therefore likely to be impossible to formulate a compulsory insolvency regime for commonhold which exactly replicates the position enjoyed by FMCs. FMCs may continue to be in a privileged position unless the freehold reversion is especially valuable, or creditors can insist that their claims are satisfied out of the service charge reserves. But some reforms to the provisions for involuntary

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\(^{61}\) These are set out in more detail in Appendix 5 in the table at para 5.13

\(^{62}\) We explain in paras 7.34 to 7.39 above why we think it necessary to compare the position of the commonhold association with that of the FMC.

\(^{63}\) Under the Landlord and Tenant Act 1987, s 42, these will include those held for current expenditure, as well as those in reserve funds.
insolvency in commonhold would go a long way towards achieving a more level playing field. This might be achieved in one or more ways:

(1) the use of the existing facility within the insolvency legislation for the commonhold association to enter into a Company Voluntary Arrangement (“CVA”);

(2) making the test of insolvency more stringent, and providing for the appointment of a “commonhold administrator” as a preliminary step before an association could be forced into liquidation; and

(3) clarifying the law surrounding the insolvency of the commonhold association, and in particular determining when:

(a) terms may be imposed by the court as a condition of making a succession order; and

(b) the liquidator might continue to impose commonhold contributions on unit owners in their capacity of members of the commonhold association.

7.49 We also consider whether the reserve funds of the commonhold should be given trust status, but do not feel able to propose any amendment.

Use of a Company Voluntary Arrangement

7.50 The insolvency of the commonhold association might be avoided by the use of routes which are available under insolvency law for companies generally. The most relevant would be the CVA. This mechanism is a legally binding agreement whereby a debtor arranges with its creditors that they will all accept a percentage of the debts owed to them (which may be paid over a period of years) in full satisfaction of what is owed to them. The advantage of this agreement to the debtor-company is that it can continue to operate and does not have to be wound-up. The advantage to the creditors is that they may each get more than they would under a winding-up: the costs incurred by the lawyers and the liquidator who acts as administrator of the arrangement are likely to be less than those which would be incurred in a winding-up; and the company can continue to generate income. In the context of a commonhold association, it would mean that it could continue to levy commonhold contributions.

7.51 In principle there would seem no reason why a creditor or creditors of a potentially insolvent commonhold association should not agree a CVA with the association, by which debts could be partially cleared in an orderly manner over a set period and the association would thereafter not be faced with the threat of liquidation. A CVA can be proposed by the directors of the company, unless the company is already in administration or liquidation, in which case the CVA would have to be proposed by the administrator or liquidator. CVAs have become increasingly attractive, provisions of the Insolvency Act 2000 make it possible to include within their provisions a statutory moratorium on actions for debt.⁶⁴ Commonhold associations would seem to be highly likely to fall within the qualifying conditions for such a “CVA with moratorium”, which

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⁶⁴ A “moratorium” would mean that, for a specified period, people to whom the association owed money would not be able to try to have it wound-up on the basis that it was insolvent.
confine their use to small private companies, although the directors are unable to propose such a CVA if a provisional liquidator has already been appointed.65

7.52 It might therefore be possible to make use of the CVA to prevent commonhold associations from being dissolved and to give greater certainty to their creditors than would apply if the association were to be dissolved. As the commonhold association is a limited company, the CVA would appear to be available as a device to use in the case of possible insolvency, whether or not express provision is made for it. We invite consultees’ views as to whether any adaptations to the CVA procedure would make it more relevant and effective when applied to commonholds. That said, having a bespoke procedure to appoint a commonhold administrator, as described in the following paragraph, might be more appropriate to the distinct circumstances of the commonhold association.

The appointment of a ‘commonhold administrator’ as a preliminary to avoid an unnecessary winding-up

7.53 A commonhold may sometimes perhaps become subject to insolvency proceedings when its debts exceed the value of its assets, but that might in fact be premature if the commonhold association could fairly easily be restored to financial health. We propose that two ideas could be considered:66

(1) the principle that a commonhold association can be put into liquidation only if it is “irretrievably insolvent”,67 and

(2) the concept of appointing a “commonhold administrator” to help ensure that associations were not forced prematurely into insolvent liquidation.

7.54 These ideas are interrelated, and would involve the following steps.

(1) A creditor would petition the court to appoint a commonhold administrator, rather than a liquidator.

(2) The administrator would take over the running of the commonhold association from its directors, review the finances of the association, and determine whether it was irretrievably insolvent.

(3) If the association could be returned to solvency within a set period,68 by the administrator requiring the unit owners to make contributions to the shared costs which were realistically affordable, then the administration would continue for that

65 I F Fletcher, The Law of Insolvency (5th ed 2017), ch 15.
66 The idea of appointing a commonhold administrator to determine whether a commonhold association was “irretrievably insolvent” was used in the context of the “restricted liability” regimes of the 1990 and 1996 Draft Bills, but it could be imported into the limited liability introduced by the CLRA 2002.
67 This term was defined in the 1990 Draft Bill, cl 69(2): “A commonhold association is to be regarded as irretrievably insolvent if it cannot pay its debts as they fall due and there is no reasonable prospect of securing that it will be able to do so in future.” Commonhold: A consultation paper (1990) Cm 1345, and accompanying draft Bill.
68 This would be subject to consultees’ views, but could be, say, two years.
period. At that point the administrator would return control of the association to the directors.\footnote{For the meaning of “contributions to shared costs”, see the Glossary.}

7.55 If a commonhold association cannot be returned to solvency, the administrator could petition the court for the winding up of the association. If the court agreed to this, then a liquidator would be appointed. The winding-up might involve the limited sale of assets described at paragraph 7.60 below. It would not, however, require the sale of the commonhold units themselves. The existing commonhold association would be wound-up, but a successor association could still be appointed. As the court would already have considered how far the unit owners should be required to contribute to the debts of the insolvent association, the liquidator would not be entitled to make further demands for commonhold contributions on unit owners. The liquidator would be able to recover only unpaid contributions which the association had previously demanded.

Clarifying the process and extent of liquidation

7.56 It would seem clear from the responses to our Call for Evidence that the general uncertainties surrounding the possible insolvency of the association have contributed to the lack of take-up of commonhold, especially among conveyancers and lenders. These doubts seem to focus particularly on whether or not a succession order should be made (and, if so, on what terms and conditions). If our preceding recommendations are adopted, the insolvency of the commonhold association should be an even rarer event than is at present feared. Even so, the possibility of insolvency still cannot be excluded. We think that the remaining uncertainties surrounding the position on insolvency could be mitigated if clearer guidance to the courts were given on these issues.

7.57 There appears to be a presumption in section 51(4) of the 2002 Act that a successor association will be appointed; we think that this presumption should be made more explicit.

7.58 It appears that there may be a power in section 52(4)(d) of the 2002 Act for the court to impose conditions before a succession order can be made, allowing a successor association to take over from the insolvent association. We provisionally propose that this power should be clarified so as to ensure that it is not used as a way of undermining the principle that a successor association is not liable for the debts of the previous association, except in clearly defined circumstances.

7.59 We think there may be a case for providing that the court could refuse to allow a successor association to take over if the insolvency was the result of a deliberate attempt by the commonhold association to avoid its liabilities. It is, however, difficult to draw a clear line as to when insolvency is being used in this way. We therefore invite consultees’ views below on whether the court should have a power to refuse to allow a successor association, and, if so, in what circumstances.

7.60 We think that there may also be a case for giving the court some discretion to allow a liquidator to sell off any assets belonging to the association,\footnote{This could be authorised in the liquidation proceedings relating to the insolvent association, and could be imposed as a condition of there being a successor association.} such as land capable of
development, or leisure facilities. Such an order might also require the imposition of a condition requiring appropriate amendments to the CCS. This power could be criticised on the basis that the sale of communal assets may reduce the market value of the units, and so render a unit owner's investment less secure. This risk would be mitigated if the liquidator could sell assets only subject to unit owners' existing rights, but imposing such a condition would certainly reduce the value of the assets to be sold and might render them unsaleable. In some cases, the sale of assets might have a minimal effect on the value of most of the existing units. Examples would include allowing upward development by building in attic space, or adding further storeys within the airspace over the roof. This type of development would, however, have a disproportionate effect on the value of the units most directly affected, for example, any units situated directly beneath the additional units. Compensation might perhaps be paid to the owners most directly affected.\(^71\)

7.61 We consider that sections 51(4) and 52(4)(d) of the 2002 Act should therefore be clarified. Unless there is to be an outright prohibition on the imposing of conditions, the court should exercise its discretion as to how far conditions are to be imposed. A number of questions arise on which we seek consultees' views:

1. whether the court should have discretion in imposing conditions in a succession order;

2. if so, whether that discretion should be a structured discretion (a discretion where the legislation has set out the factors to which the judge should pay most attention); and

3. if so, what factors the court should take into account.

7.62 As explained above,\(^72\) doubts have also been expressed as to how far, once a liquidation is proceeding, the liquidator may stand in the shoes of the directors of the commonhold association and continue to demand commonhold contributions from unit owners. We provisionally propose that the liquidator should be restricted to recovering:

1. any arrears of commonhold contributions; and

2. any contributions that are required to meet ongoing essential commitments (such as urgent repairs, insurance premiums, utility bills, wages of staff, and payments to contractors).

7.63 Additionally, we do not think that the liquidator should be able to demand further contributions to cover:

1. reducing the level of insolvency; or

2. requiring solvent members to make up for the shortfall in contributions from members who are bankrupt or from whom it is impossible to make a recovery.

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\(^71\) Landlord and Tenant Act 1987, s 38(10) arguably offers a precedent for this. It could be seen as unusual for such a payment to be made to an owner when the association is insolvent, but it would be allowed only where it would result in a net gain to creditors.

\(^72\) See paras 7.32 to 7.33 above.
Giving trust status to the reserve funds of the commonhold association

7.64 Leaseholders’ service charge funds have trust status.\(^\text{73}\) It has been suggested to us that a similar status could be given to reserve funds within commonholds. The terms of the statutory trust of leasehold service charge funds provide that they are held on trust to cover the costs for which they were collected. If that should no longer be possible (for example, because all the leases come to an end), then any remaining balance would be held on trust for the leaseholders who had been contributing to the fund.

7.65 We take the view, however, that the position with commonhold is fundamentally different. Leasehold service charge funds are generally held notionally by the landlord, though in practice they will most often be held by the landlord’s managing agent. Sometimes they are held by a separate management company. The management company may be an independent company owned by the leaseholders collectively. Sometimes, however, a separate management company is associated with the landlord, rather than being owned by the leaseholders. But in each of these cases, the funds are being held by a legal body which is different from the persons who have contributed to the funds.

7.66 In contrast, in commonhold, the commonhold association comprises all the unit owners, and no one else can be a member of the association. There is therefore always an identity of interests between the unit owners and the association, and it would be an unnecessary complication for the association not to be the beneficial owner of its own funds.\(^\text{74}\)

Consultation Question 30.

7.67 We invite consultees’ views as to whether any requirements of company law (such as to make an annual confirmation statement, and to file accounts) should be relaxed for commonhold associations.

Consultation Question 31.

7.68 We invite consultees’ views as to whether there are particular difficulties in applying CVAs to commonhold associations.

7.69 We invite consultees’ views as to whether the CVA procedure needs any adaptations to make it more relevant and effective in dealing with commonhold associations in financial difficulties.

\(^{73}\) Landlord and Tenant Act 1987, s 42.

\(^{74}\) “Beneficial owner” is the legal term used when someone is the full owner of a sum of money, or another asset.
Consultation Question 32.

7.70 We provisionally propose that it should not be possible for creditors directly to petition for a commonhold association to be wound-up, and a liquidator appointed. Instead, a petition could lead to the court appointing a commonhold administrator, who would carry out the necessary duties.

Do consultees agree?

7.71 We provisionally propose that a commonhold administrator should then be able to petition for the association to be wound-up only if the commonhold association is irretrievably insolvent.

Do consultees agree?

Consultation Question 33.

7.72 We provisionally propose that the law should be clarified to ensure that there is a presumption that, on the insolveney of a commonhold association, a successor association should usually be appointed.

Do consultees agree?

7.73 We invite consultees’ views as to whether there are circumstances in which it would not be appropriate for the court to appoint a successor association and, if so, what these circumstances are.

7.74 We provisionally propose that the court should have discretion as to whether to impose conditions for a successor association to be appointed.

Do consultees agree?

7.75 We invite consultees’ views as to:

(1) what conditions might be imposed; and

(2) if the court’s discretion is to be structured, what factors the court should take into account.
Consultation Question 34.

7.76 We provisionally propose that, if a liquidator is appointed to wind up a commonhold association, he or she should not be able to demand further contributions from the unit owners to reduce the level of indebtedness of the association.

Do consultees agree?

7.77 We provisionally propose that, if a liquidator is appointed to wind up a commonhold association, he or she should not be able to demand further contributions from the unit owners to make up for the shortfall in contributions from members who are bankrupt or from whom it is impossible to recover their contributions.

Do consultees agree?
Part V: The commonhold community
Chapter 8: The commonhold community statement

INTRODUCTION

8.1 Every commonhold must have a commonhold community statement ("CCS"). The CCS sets out the rights and obligations of both the commonhold association and the unit owners, in relation to the property. The CCS is also the document which defines the physical boundaries of the commonhold units (and also, therefore, the common parts) in a particular commonhold.¹

8.2 The rights and obligations created by the CCS relate to particular units, rather than specific owners. As a result, when a commonhold unit is sold to a new owner, the new owner will take on the rights and obligations that are attached to that unit, and the previous owner will be released from them. In this way, the CCS enables flats to be owned on a freehold basis without the insecurity that comes with flying freeholds.² By setting out these rights and obligations, the CCS performs a similar function to a lease, but presents a number of significant advantages.

(1) The terms of the CCS are prescribed by the Commonhold Regulations (although there is some scope to vary the terms to suit the needs of a particular commonhold). Consequently, most terms of the CCS are standardised across different commonholds, which simplifies the conveyancing process and improve consumer understanding. Additionally, prescribing the main terms of the CCS in regulations means that secondary legislation can be used to amend these terms to respond to changing needs.

(2) Any information or rules that are specific to a particular commonhold must be grouped in particular places in the CCS (either in separate annexes at the end, or at the end of each section or Part). As a result, the rules specific to a commonhold can be readily identified by prospective purchasers and their conveyancers. This layout also helps standardise the CCS so individuals may move to a different commonhold but still be familiar with the CCS, and know where to find the information specific to that commonhold.

(3) An often-cited advantage of the CCS is that the main rights and obligations of all unit owners in the commonhold are the same (with some scope for different voting rights and financial contributions to be allocated to different units) and are set out in the same document. This position differs from that in a block of leasehold flats, where the individual flat leases may contain terms which are inconsistent with each other.

(4) The obligations within the CCS are owed to the commonhold association (which is made up of the unit owners) by the unit owners; and owed by the commonhold association to the unit owners. In other words, those who owe obligations will

¹ Commonhold Regulations 2004, sch 3 para 1.1.1.
² See ch 1, paras 1.19 to 1.21.
also be owed obligations, and vice versa. Other than the prescribed terms, the terms of the CCS can be written (and subsequently amended) by those who are bound by them, giving unit owners collectively the power for self-governance.

8.3 The CCS governs issues which relate to all aspects of commonhold. This chapter focusses on the overarching structure of the CCS, and broad questions relating to the CCS as a whole, including the ability to tailor the CCS to a particular commonhold. Issues relating to specific provisions of the CCS are dealt with in other chapters.

(1) Chapter 5 discusses flexibility in the CCS for mixed-use and multi-block developments;

(2) Chapter 6 discusses development rights in the CCS;

(3) Chapter 9 includes discussion of the insurance provisions in the CCS;

(4) Chapter 9 also discusses the management and maintenance provisions, such as the repairing obligations in the CCS;

(5) Chapter 12 discusses the current restrictions in the CCS on granting long leases;

(6) Chapter 10 discusses the commonhold contributions, and the ability of the commonhold association to enforce the obligations in the CCS; and

(7) Chapter 13 discusses the dispute resolution provisions in the CCS.

8.4 The current operation of the CCS is discussed in more detail below. We then set out some of the criticisms of the current model, and suggest possible options for reform.

THE CURRENT LAW

8.5 As explained above, every commonhold must have a CCS. The CCS is sent to HM Land Registry at the same time as the application to register the land as commonhold. The CCS sets out the rights and duties of the commonhold association and unit owners in a commonhold. It also imposes certain obligations on a tenant who rents a unit from the unit owner.

8.6 The rights and obligations in the CCS are additional to any rights and obligations the parties may have under general law.

8.7 When commonhold was first introduced, Government published guidance on drafting the CCS. The guidance summarised the different types of provisions contained in a CCS as follows.

Every CCS is likely to contain 3 types of provision. First are those that are prescribed by the [Commonhold] Regulations, such as the procedures for raising money or

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3 CLRA 2002, s 31(1).

4 Commonhold Regulations 2004, sch 3 para 1.1.2. The obligations a CCS can impose on tenants are discussed further at para 8.19 below.

5 Commonhold Regulations 2004, sch 3 para 1.1.3.
resolving disputes. These provisions are set out in the model CCS. They will apply irrespective of whether the draftsman includes them, but it is intended that they should appear on the face of the CCS. These provisions cannot be amended. The second type are those provisions, such as the description of the units or the allocation of voting rights, which will be unique to the commonhold in question, but which must be inserted in the CCS to enable the commonhold to operate. The model CCS prescribes the format in which this information must be presented in Annexes 1 to 4. Special restrictions apply to the amendment of most of these provisions. The final category are the supplementary provisions that do not appear in the model CCS. These provisions must be clearly identified. Subject to any special rules added to the CCS to restrict their amendment, these provisions can be amended so long as a majority of the members of the commonhold association agree. The provisions in the second and third categories are referred to as local rules.6

8.8 Under the current law, a CCS has the following structure: 7

1. Part 1 contains general provisions which apply to all commonholds. Annex 1 should be filled in by those creating the commonhold to provide details specific to the commonhold.

2. Part 2 and Annex 2 define the units and common parts within the commonhold.

3. Part 3 and Annex 3 set out the percentages of the shared costs allocated to each unit, and the allocation of votes for each unit.

4. Part 4 and Annex 4 set out the rights and duties of the commonhold association and unit owners, including the dispute resolution and enforcement procedures.

Additionally, as noted above, supplementary local rules specific to a particular commonhold may be adopted in certain circumstances (for instance, to address “development rights” – discussed further in Chapter 6). We consider local rules in more detail below.

Local rules

8.9 To draw buyers’ attention to the rules which are specific to the commonhold, local rules can only be included at the end of a Part or section, or in a separate annex, under the heading “provisions specific to this commonhold”.8 The rule or annex must also be referred to in the table of contents of the CCS.

8.10 Many of the local rules will be added into the standard CCS at the point the commonhold is set up, although they can be amended or added to at a later date (as discussed below). It is worth noting that the majority of CCSs will be drawn up initially by the developers of the commonhold. When deciding what local rules to incorporate, the developer will choose the local rules that suit them at that time. This decision is likely to be driven by what is most popular in the housing market at that time. However, for those

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6 Department for Constitutional Affairs, Guidance on the drafting of a Commonhold Community Statement including Specimen of Local Rules (December 2004), para 14.

7 Commonhold Regulations 2004, sch 3 paras 1.3.1 to 1.3.5.

who are living in the commonhold, what local rules best suit them may evolve over time, especially as original owners move out and new owners move in. For instance, unit owners may wish to change the local rules of their commonhold to take advantage of changes in technology. For this reason, the ability to amend or add local rules at a later date needs particular consideration.

8.11 Local rules can normally be added or amended by an “ordinary resolution”. The Government guidance published when commonhold was introduced provides examples of local rules which could be adopted, and also gives guidance for those setting up a commonhold on how to fill in the Annexes to the CCS.

8.12 It is often envisaged that local rules will be about pets, or noise outside certain hours. However, local rules could be almost anything, subject to the general law, and to the following specific restrictions.

(1) Local rules cannot “provide for the transfer or loss of an interest in land on the occurrence or non-occurrence of a specified event”. For example, the CCS could not require a unit to be sold due to a unit owner’s breach of the CCS.

(2) Local rules cannot prevent or restrict the creation, transfer or grant by a unit owner of an interest in the whole or part of his or her unit. For example, the CCS cannot prevent a unit owner selling or mortgaging his or her unit, or make the sale subject to the commonhold association’s consent.

(3) Local rules have no effect if they are:

(a) inconsistent with any provision of the 2002 Act;

(b) inconsistent with any mandatory provisions set out by the Commonhold Regulations;

(c) specifically prohibited by regulations (although, at present, the Commonhold Regulations do not set out any specifically prohibited local rules); or

(d) inconsistent with the articles of association of the commonhold association.

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9 An ordinary resolution requires either over 50% of the votes cast to be cast in favour if the vote is taken at a meeting, or over 50% of all votes in the commonhold to be cast in favour if the written resolution procedure is used. See para 8.15 for further discussion of amending local rules.

10 Department for Constitutional Affairs, Guidance on the drafting of a Commonhold Community Statement including Specimen of Local Rules (December 2004).

11 CLRA 2002, s 31(8).

12 See ch 14 on enforcement.

13 CLRA 2002, s 20(1). We discuss this provision in more detail at para 8.27 onwards.

14 Commonhold Regulations 2004, sch 3 para 1.1.5.
8.13 It would be possible to add a local rule which specifies that it can only be changed by a "special" or "unanimous resolution".\(^\text{15}\) However, it would seem that such a rule could be introduced by an ordinary resolution, allowing a bare majority to entrench something which is then much harder to remove than it was to add.\(^\text{16}\)

8.14 It is unclear whether a local rule may specify that it cannot be changed at all. The 2002 Act states that a CCS must make provision about how it can be amended.\(^\text{17}\) However, this section does not expressly rule out the possibility of specific local rules which cannot be amended.\(^\text{18}\) For example, in three of the existing commonholds the CCS provides that the commonhold association has no power to change the local rules allocating parking spaces as limited use areas for each unit.\(^\text{19}\) In practice, it would seem that a local rule entrenched in this way could still be changed with the unanimous agreement of the unit owners (and their mortgage lenders).

**Amending the terms of the CCS**

8.15 As there is a prescribed form for the CCS which must be adopted, there is limited scope for amending the terms of the CCS. Neither the prescribed rules in Parts 1 to 4, nor the prescribed format of Annexes 1 to 4, can be amended.\(^\text{20}\) However, local rules can be amended with the appropriate majority and any necessary consents.\(^\text{21}\) Figure 20 below sets out the provisions of the CCS which can be amended (almost all of which are local rules), and what majority is required for such amendments to be made.

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\(^{15}\) A special resolution requires either 75% of the votes cast to be cast in favour if the vote is taken at a meeting, or 75% of all votes in the commonhold to be cast in favour if the written resolution procedure is used. A unanimous resolution requires either 100% of the votes cast to be cast in favour if the vote is taken at a meeting, or 100% of all votes in the commonhold to be cast in favour if the written resolution procedure is used.

\(^{16}\) Entrenching rules involves increasing the permanence of those rules by making it harder for them to be changed at a later date, for instance by requiring a higher majority vote.

\(^{17}\) CLRA 2002, s 33.

\(^{18}\) As, for instance, the CCS also states that the mandatory provisions prescribed by the Commonhold Regulations 2004 cannot be altered.

\(^{19}\) A limited use area is an area within the common parts which has been designated for the exclusive use of one or more unit owners. Limited use areas will be specified in the CCS.

\(^{20}\) Commonhold Regulations 2004, sch 3 para 4.8.2.

\(^{21}\) Commonhold Regulations 2004, sch 3 para 4.8.4.
<table>
<thead>
<tr>
<th>Rule being changed</th>
<th>Majority (and other consents) required for amendment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changing CCS to add land to the commonhold.</td>
<td>Unanimous resolution (CCS paragraph 4.7.10).</td>
</tr>
<tr>
<td>Changing rights for, or over, a commonhold unit in paragraphs 6 or 7 of Annex 2.</td>
<td>Unit owner and holder of any registered charge over that unit (for instance, a mortgage lender) must consent in writing (CCS paragraph 4.8.5).</td>
</tr>
<tr>
<td>Removing a unit owner from the list of Authorised Users of a “limited use area” in paragraph 4 Annex 4.</td>
<td>Unit owner and holder of any registered charge over that unit (for instance, a mortgage lender) must consent in writing (CCS paragraph 4.8.6).</td>
</tr>
<tr>
<td>Changing permitted use of a unit in paragraph 2 Annex 4.</td>
<td>Special resolution, and the unit owner in question has consented in writing (CCS paragraph 4.8.7).</td>
</tr>
<tr>
<td>Changing boundaries of a unit (including when land from a unit is added to the common parts).</td>
<td>Special resolution, and the unit owner in question and holder of any registered charge over that unit (for instance, a mortgage lender) must consent in writing (CCS paragraph 4.8.8, 9 and 10).</td>
</tr>
<tr>
<td>Varying the percentage of the commonhold contributions allocated to a unit.</td>
<td>Special resolution (CCS paragraph 4.8.11). The variation must not allocate a significantly disproportionate percentage of the contribution to any unit owner.</td>
</tr>
<tr>
<td>Varying the number of votes allocated to a unit owner.</td>
<td>Special resolution (CCS paragraph 4.8.11). The variation must not allocate a significantly disproportionate number of votes to any unit owner.</td>
</tr>
<tr>
<td>Amending any other local rules.</td>
<td>Ordinary resolution (CCS paragraph 4.8.3).</td>
</tr>
<tr>
<td>Changes to the CCS to include provisions required by the 2002 Act or Commonhold Regulations, or to remove provisions prohibited by or inconsistent with the Act or Regulations. This is the only time that changes are permitted to non-local rules.</td>
<td>By the directors, with no resolution of the members (CCS paragraph 4.8.14).</td>
</tr>
</tbody>
</table>
8.16 Once the resolution to amend has been passed, the directors must apply to HM Land Registry to register the amended CCS.22 The amendments will only take effect following registration.23

8.17 As part of the survey of current commonholds, unit owners were asked whether they had ever wanted to add or change any rules in the CCS.24 Of the 31 owners who responded, seven said that they had tried to change the CCS. The desired changes included “banning holiday homes”; making “the properties more soundproof”; banning pets; restricting “movement through the car park”; and preventing the “display of washing”.

8.18 All of the unit owners who wished to make changes to the CCS explained that they had been unable to do so, usually because they could not obtain the required number of votes in favour of the change. One unit owner explained that after being unable to make the changes to the CCS, the unit owners wrote a welcome document for new owners outlining some of the conventions agreed by a number of unit owners.25

Application of the CCS to tenants

8.19 In addition to imposing rights and obligations on unit owners and the commonhold association, the CCS also imposes certain obligations on tenants of unit owners. In particular, tenants must not use the unit or common parts for any purpose other than their permitted use26 and must comply with the rent diversion procedure outlined in Chapter 14. Before granting a tenancy, unit owners are required to provide tenants with a copy of the CCS and a notice informing the tenants that they will be required to comply with certain provisions of the CCS. If a unit owner fails to do so, and the tenant suffers a loss, the unit owner may be required to compensate the tenant.27 It is also likely that many local rules, such as rules relating to noise or pets, will be drafted to apply to tenants as well as unit owners.

CRITICISMS OF THE CURRENT LAW

8.20 Two main concerns have been raised by commentators and consultees responding to our Call for Evidence: the "one-size-fits-all" approach of the CCS is an unwelcome constraint; and the CCS can too easily be changed at a later date. These concerns raise two competing interests: the need for flexibility in the commonhold regime; and the need to provide unit owners and purchasers with certainty. Introducing greater flexibility necessarily requires some loss of standardisation, and vice versa. We feel that a balance must be struck between these objectives, and when examining the options for reform below, we discuss where to strike the balance for each of the issues.

22 Commonhold Regulations 2004, sch 3 para 4.8.15.
23 Commonhold Regulations 2004, sch 3 para 4.8.16.
24 See ch 1, para 1.40.
26 Commonhold Regulations 2004, sch 3 paras 4.3.1 to 4.3.2.
In our Call for Evidence, we explained that the CCS has been criticised for its one-size-fits-all approach. A number of developers responding to our Call for Evidence confirmed that commonhold in its current form does not offer sufficient flexibility to accommodate the developments they build. In this chapter, we consider whether greater flexibility could be introduced into the CCS, by removing certain restrictions on the creation of local rules. However, the majority of concerns raised by developers relate specifically to the flexibility of the CCS, and the commonhold model more generally, to accommodate more complex developments. In Chapter 5 we consider how commonhold works for mixed-use and multi-block developments in more detail, and suggest provisional reforms to better address the balance between flexibility and standardisation. In Chapter 10 we also consider whether the provisions relating to the commonhold contributions should be more flexible.

A number of consultees raised concerns about how easily the CCS can be changed by the commonhold association at a later date. In its response to our Call for Evidence, Berkeley Homes pointed out that most local rules can be changed by an ordinary resolution, which only requires a majority vote of a those attending the meeting. As only 20% of unit owners are required to turn up for a meeting for decisions to be valid (referred to as the “quorum”), changes could be made to local rules with only 11% of unit owners actively voting in favour of the amendment. For some provisions which have little effect on unit owners’ use and enjoyment of their property, this might not be particularly problematic: for instance, rules about displaying posters in the common parts. However, consultees suggested that it might be desirable to make other provisions, which may have a greater impact, harder to change, to help protect the expectations of unit owners when they purchased their units.

Finally, whilst not raised by consultees to our Call for Evidence, we consider that the form of the CCS could usefully be revised to make it easier to identify rules which are specific to the commonhold. Below, we consider these issues in more detail and set out options for reform.

PROPOSALS FOR REFORM

As explained in paragraphs 8.1 and 8.2 above, the CCS plays an important role in creating rights and obligations in the commonhold, as well as defining the commonhold units and common parts. In addition to these, the CCS has two other important functions.

1. **Forming the constitution of the commonhold** – the CCS sets out how the relationships in the commonhold are to work. In leasehold, the terms of the leases can be used to create a development with a certain ethos or character, for example, a retirement village, or an environmentally sustainable block of flats. The CCS is the way in which the nature of a commonhold can be set, by specifying certain things which should or should not happen, or placing particular duties on unit owners and the commonhold association. Here, the CCS is playing a constitutional role, setting out some of the values and ideas which are to govern the commonhold. For instance, a CCS could require the commonhold association to consider the environmental impact of its decisions; to carry out an energy

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28 See Commonhold: A Call for Evidence – Analysis of Responses, questions 3 and 5.
efficiency survey at periodic intervals; and to propose measures to reduce the energy consumption of the building periodically.

(2) **Facilitating broader policy objectives** – the primary function of the CCS is to set out the rights and obligations of the commonhold association and the unit owners. As terms of the CCS are prescribed by secondary legislation, the CCS can also be used to implement broader policy objectives such as consumer protection. For example, if evidence of abuse or bad practice arises over time, secondary legislation could be introduced to place limits on what local rules can be created by the commonhold association, or place specific disclosure requirements on the developer.

We have kept these functions in mind when considering options for reform.

**Freedom to create local rules**

8.25 As discussed at paragraph 8.12 above, the 2002 Act and Commonhold Regulations provide some restrictions on which local rules can be added to the CCS. The rules cannot contravene the 2002 Act, Commonhold Regulations or any general law of England and Wales, including anti-discrimination law. Additionally, the 2002 Act sets out two specific restrictions on the creation of local rules within commonhold:

(1) a local rule cannot restrict a unit owner’s ability to create, transfer or grant an interest in his or her unit; and

(2) a local rule cannot provide for the loss of someone’s interest in particular circumstances.

8.26 Below, we discuss these specific restrictions in more detail and ask whether the restrictions serve a useful purpose or should be amended or removed.

**Restriction on unit owners granting interests in their units**

8.27 Currently, local rules cannot limit the ability of unit owners to create, transfer or grant interests in their units (subject to specific restrictions on granting leases imposed by the Commonhold Regulations: see Chapter 12). For example, a unit owner should not be prevented or restricted in selling or mortgaging their unit. However, we are aware of two areas where the law is currently unclear, and requires further consideration:

(1) whether a CCS can prohibit letting, such as short-term holiday lets; and

(2) whether a CCS can include provision for payment of event fees.29

**Prohibiting letting (including holiday lets)**

8.28 The Commonhold Regulations impose certain restrictions on the creation of leases within commonhold. These include a prohibition on leases over seven years in length.30 However, it is unclear whether the current law allows a CCS to include terms which

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29 Event fees are terms in a lease which require the leaseholder to pay a fee on the occurrence of certain events, such as sale, sub-letting or change of occupancy.

30 See ch 12 for further discussion of leases within commonhold.
impose further restrictions on unit owners letting their commonhold units, such as terms prohibiting short-term holiday lets. In order to make proposals to clarify the law, we first consider whether a CCS should be able to restrict unit owners letting their units.

8.29 In other jurisdictions, preventing the equivalent of commonhold associations from banning letting has caused particular issues in relation to holiday letting, and has often led to litigation. In blocks with shared areas, holiday letting can cause disturbance for neighbours, and can increase pressure on shared facilities. In jurisdictions such as New South Wales in Australia, associations have consequently tried to ban such letting, even though these restrictions are not permitted. Holiday letting within leasehold has also led to litigation arising in England and Wales.

8.30 It could be argued that as a freehold owner, a unit owner should be free to decide whether he or she wishes to licence or lease out the property. However, many commonholds will be blocks of flats, and therefore will have shared areas, with owners living in close proximity to one another. Imposing restrictions on letting, including holiday lets, could perhaps be justified in the interests of reducing disturbance to other unit owners, and reducing the impact on common areas. Associations in other jurisdictions have relied on these arguments to support the claim that they should be allowed to restrict holiday letting.

8.31 We provisionally propose that the law should be clarified, explicitly to permit the CCS to restrict letting of units should those setting up the commonhold, or the commonhold association, wish to introduce such a restriction. Whether or not to prevent unit owners from letting their units (on either a licence or short-term lease basis) would then be a matter for each commonhold to decide. This reform would allow a CCS to prohibit holiday letting, amongst other things.

8.32 We note that the focus of concern lies with short-term holiday letting. An ability for the CCS to restrict unit owners granting interests would, however, potentially have a further reach. In particular, it could be used to prevent unit owners from granting any lease of their unit, including a lease granted by a buy-to-let owner, or a social housing provider. We think this possibility raises additional policy questions. Such restrictions could have a negative impact on the private and social rented markets. Further, a ban on private

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31 The CLRA 2002, s 20 provides that a CCS may not prevent or restrict the creation, grant or transfer by a unit owner of an interest (etc), other than by the restrictions provided for in ss 17 to 19. Section 17 restricts the ability to create residential leases, unless those leases satisfy “prescribed conditions”, which are set out by the Commonhold Regulations 2004, reg 11. Section 18 of the CLRA 2002 explicitly allows the CCS to impose restrictions on non-residential leases. The effect of these provisions is not beyond doubt.


33 In the majority of cases, holiday lets are granted by a licence, although occasionally a short-term lease may be used instead. A licence gives a person permission to use property for a particular purpose, but does not give rise to any proprietary interest. It is unclear under the current law whether a CCS may restrict the creation by unit owners of either short-term leases or licences of their units.

34 The CCS could prevent, for instance, the grant of leases of any length, even those for a duration shorter than seven years. In ch 12 we propose permitting shared ownership leases and lease-based home purchase plans of any length within commonhold. An ability for the CCS to restrict unit owners to grant interests would, however, potentially restrict this ability.
renting may impact unduly on those who buy a unit as their home, but for unexpected reasons wish to rent the unit for a period of time; for example, because they are going overseas to work; require a period of residential care following an accident or illness; or need to be absent to care for a family member.

8.33 We think there are good reasons not to enable a CCS to prevent units being rented out as homes in the private or social rented sectors. One difficulty, however, is that there is no clear means of determining whether a unit is being rented as a "holiday let" on the one hand, or has been rented out to someone as his or her home on the other. In the private sector, rented accommodation is generally granted on an "assured shorthold tenancy". While these can be granted for any length, six-month or one-year periods are commonly used. While the division may not be perfect, enabling a CCS to prevent lettings of less than six-months' duration, will achieve the desired policy objective in relation to private sector renting. In particular, it will reduce the disturbance that may be caused by a continuously changing group of occupiers and the pressures on common parts. We invite consultees' views as to alternative means of drawing the distinction.

8.34 We are aware that some forms of social rented housing use tenancies of less than six-months' duration. The ability of the CCS to restrict lettings could be limited to the private rented sector. Such a provision could be made on the basis of the landlord's identity (such as preventing a CCS from limiting the ability of registered providers of social housing and housing associations to let units). We invite the views of consultees on whether a limitation of this kind would be sufficient to prevent the CCS from being able to restrict units being let in the social rented sector.

<table>
<thead>
<tr>
<th>Consultation Question 35.</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.35 We provisionally propose that it should be possible for the CCS to impose restrictions on the short-term letting of units.</td>
</tr>
<tr>
<td>Do consultees agree?</td>
</tr>
<tr>
<td>8.36 We invite consultees’ views as to how to ensure that any restriction on short-term letting does not prevent units being rented in the private or social rented sector. In particular:</td>
</tr>
<tr>
<td>(1) in relation to the private rented sector, we invite views on whether any restriction imposed by a CCS should be confined to lettings made for less than six-months, or for any other specified period;</td>
</tr>
<tr>
<td>(2) in relation to the social rented sector, we invite views on whether any restriction imposed by a CCS should not be able to apply to particular landlords, such as registered providers of social housing and housing associations, or whether there are other ways of ensuring that such lettings cannot be prohibited in the CCS.</td>
</tr>
</tbody>
</table>
**Event fees**

8.37 Leases sometimes include terms which require the leaseholder to pay a fee on the occurrence of certain events, such as sale, sub-letting or change of occupancy. These are known as "event fees", and may be payable to the freeholder, the developer, or the managing agent.\(^\text{35}\) Of the 17 commonholds currently in existence, one has included an event fee in its CCS. This CCS requires that on sale of a unit, the selling unit owner "must ensure that 0.75% of the sale price of the commonhold unit is contributed to the reserve fund".

8.38 However, it is questionable whether event fees are in fact permitted by the 2002 Act. As such fees will often be payable on the sale of a unit, the requirement to pay a fee might be considered a restriction on unit owners' ability to sell their units. Such restrictions are prohibited by the 2002 Act.\(^\text{36}\) We consider that the law would benefit from clarification in this area.

8.39 Before the law can be clarified, we must first consider whether event fees should ever be permitted within commonhold. Event fees are controversial and have scope to be abused. For instance:

1. event fees may be triggered in circumstances which the unit owner may not expect or which come as a surprise;

2. event fees and their financial consequences are not always clear to consumers when they are deciding whether to purchase a property; and

3. event fees may exploit consumers' "behavioural biases", which means that consumers may not take event fees into account when making a decision to purchase a property.\(^\text{37}\)

8.40 Within commonhold, event fees could require the payment of a fee to the commonhold association or even to an external third-party. The potential for a CCS to require payment of an event fee to a third-party is particularly concerning. The developer, for instance, could include a requirement in the CCS for fees to be paid to him or her, despite no longer being involved with the commonhold. However, in many cases, these fees are unlikely. Additionally, in most cases it is difficult to see why it would be justifiable for a commonhold association to collect such fees, although event fees could potentially be used to increase the reserve fund of a commonhold. However, these fees are unlikely to be necessary in light of our proposals for unit owners annually to contribute to mandatory reserve funds.\(^\text{38}\)

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\(^{35}\) The Law Commission has previously looked at event fees in retirement properties: Event Fees in Retirement Properties (2017) Law Com No 373. Para 1.5 of this report notes that event fees may also go by a variety of other names, including exit fees, transfer fees, deferred management fees, contingency fees and selling service fees.

\(^{36}\) CLRA 2002, s 15(2).

\(^{37}\) See further Event Fees in Retirement Properties (2017) Law Com No 373, paras 2.3 to 2.10.

\(^{38}\) See further ch 10.
8.41 We therefore provisionally propose below that event fees should be prohibited in commonhold, except any specific circumstances expressly permitted by statute.

8.42 In our report on event fees, we explained that event fees are often used in leases in the retirement sector to make specialist retirement housing affordable to consumers. Older people are often “asset rich, but cash poor”. Event fees can help by subsidising high operating costs which would otherwise result in high service charges for leaseholders. We invite the views of consultees as to whether event fees could be similarly useful for specialist retirement properties in a commonhold context. Although event fees are very rare outside of the retirement context, we also invite consultees to tell us if they are aware of any other circumstances, apart from specialist retirement properties, in which event fees should be permitted within commonhold.

Consultation Question 36.

8.43 We provisionally propose that event fees should be prohibited within commonhold, except for any specific circumstances expressly permitted by statute.

Do consultees agree?

8.44 We invite consultees’ views as to whether an exception to the proposed prohibition on event fees should be made for specialist retirement properties within commonhold.

8.45 We invite consultees’ views as to whether there are any other circumstances (apart from specialist retirement properties) in which event fees should be permitted within commonhold.

Other limits on creating local rules

8.46 Aside from the restrictions discussed above, and subject to the general law of England and Wales, any local rule can be added to the CCS. We invite consultees’ views as to whether any further restrictions should be put in place to limit which local rules may be added to the CCS. For instance, such restrictions could relate to the permitted use or ownership of a unit.

Consultation Question 37.

8.47 We invite consultees’ views as to whether any further restrictions should be put in place to limit which local rules may be added to the CCS.

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Amending the CCS

8.48 There are two ways in which a CCS may be altered: by amendment of the standard provisions prescribed by the Commonhold Regulations; and by the commonhold association changing the local rules. We discuss each of these possibilities in more detail below.

Amendment of the Commonhold Regulations

8.49 An advantage of commonhold is that the model CCS can be amended by statutory instrument, in order to respond to changing markets, circumstances and any abuses which arise at a later date. As one example, Government might seek to introduce a right for all unit owners to be allowed to install, at their own expense, electric car charging points in the common parts.\(^{40}\) This change could be made by amending the mandatory provisions of the CCS as set out in regulations.

8.50 An example of this advantage in practice can be found in New South Wales, when the problem arose of associations preventing unit owners adding safety catches to windows in high-rise apartments. This prohibition was a particular concern for those unit owners with children. This concern was addressed by a change to the standard provisions to provide a non-amendable right for unit owners to install safety catches. In paragraphs 8.70 to 8.76 below, some of the practicalities which affect amendment of the Commonhold Regulations are discussed in more detail.

Amendment by the commonhold association

8.51 Currently, almost all local rules can be amended by an ordinary resolution,\(^{41}\) meaning that over 50% of the votes cast at a meeting must be cast in favour.\(^{42}\) This approach reflects the democratic principles that underpin commonhold. However, as discussed at paragraph 8.22 above, some consultees argue that it is too easy to make significant changes to the commonhold. Stakeholders have told us that it would be desirable for certain provisions to be harder to change to protect the expectations of purchasers. Doing so would allow unit owners to buy into the ethos of a specific commonhold development with confidence that the ethos will remain in place.

8.52 We agree with the concerns of stakeholders and see two main issues with the approach of the current law.

(1) Local rules can affect how people are able to use their own freehold unit. Changes to such rules should not be made lightly. Whilst certain variations, such as to alter the permitted use of a unit, will require the consent of that unit owner (for instance, if a unit was being changed from residential to commercial) others will not. Decisions banning pets or changing the underlying ethos of a commonhold could have at least the same level of impact on a unit owner, and could make it very difficult or unpleasant for a unit owner to stay in their home.

\(^{40}\) The ability of homeowners to install charging point for electric cars has been the subject of recent discussions in Parliament. *Hansard* (HL) 17 May 2018 vol 791 cols 830 to 839; *Hansard* (HL) 5 June 2018 vol 791 cols 1257 to 1261.

\(^{41}\) See figure 20 above for a list of the exceptions.

\(^{42}\) Alternatively, it could be passed by the written resolution procedure, with the support of over 50% of the available votes.
For instance, under the current law, a unit owner with a pet dog could choose to purchase a unit in a commonhold which permitted pets. At a later date, the commonhold association could vote by ordinary resolution to ban pets from the commonhold, forcing the owner to move the dog out of the property, or the owner to move out of the property himself or herself.

Purchasers have particular expectations when they move into a block as to their rights and obligations. The current position provides little certainty as to what an owner's rights and obligations may be in the future. Providing greater certainty would give purchasers more confidence in buying a commonhold unit.

As we have explained at paragraph 8.14 above, some of the existing commonholds contain local rules which specify that they cannot be changed by the commonhold association. It is, however, unclear whether such a provision is permitted, or how effective it is.

To improve the current position, we provisionally propose below that a higher voting majority for amending the CCS should be introduced. However, there are two further questions which must be answered in conjunction with this proposal: what should the higher threshold for amending the CCS be; and should that increased threshold apply to all rules in the CCS, or only some? Below, we outline options for reform in response to these questions, and then invite the views of consultees as to which approach should be adopted.

**Voting thresholds**

It would not be viable to require 100% of all the unit owners in the commonhold to vote in favour of a change, as obtaining such consent may be practically impossible (as discussed in Chapter 3 on converting existing buildings to commonhold). Alternative voting thresholds that could be adopted from elsewhere in the commonhold framework would be:

1. a special resolution;
2. a unanimous resolution; or
3. 80% of all unit owners.

There are two ways in which either a special resolution or a unanimous resolution can be carried out: as a vote taken in a meeting, or as a written resolution. If the vote is taken in a meeting, then either 75% (special resolution) or 100% (unanimous resolution) of the votes cast at that meeting must be cast in favour. If the written resolution procedure is used, then 75% or 100% of all the votes in the commonhold must be cast in favour to pass the resolution.

The table in figure 21 illustrates how each of these voting thresholds would operate in practice: how many of the votes in the commonhold would need to be cast in favour of a change, and how many would need to vote against the change in order to prevent it happening.
<table>
<thead>
<tr>
<th>Resolution</th>
<th>Minimum required to vote in favour of change</th>
<th>Minimum required to vote against in order to block change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Special resolution</strong></td>
<td>At a meeting: 75% of 20% quorum&lt;sup&gt;43&lt;/sup&gt; (15% of all the votes in the commonhold).</td>
<td>Dependent on numbers voting. Must be rejected by over 25% of those voting. For example, if minimum quorum of 20% voting, over 25% of that amounts to over 5% of all the votes in the commonhold. If written resolution procedure is used, over 25% of all the votes in the commonhold must be cast against.</td>
</tr>
<tr>
<td></td>
<td>Written resolution: 75% of all the votes in the commonhold.</td>
<td></td>
</tr>
<tr>
<td><strong>Unanimous resolution</strong></td>
<td>At a meeting: 100% of 20% quorum (20% of all the votes in the commonhold)</td>
<td>One unit owner must vote against, regardless of how many voting.</td>
</tr>
<tr>
<td></td>
<td>Written resolution: 100% of all the votes in the commonhold.</td>
<td></td>
</tr>
<tr>
<td><strong>80% of all unit owners</strong></td>
<td>80% of all the votes in the commonhold</td>
<td>Over 20% of all the votes in the commonhold.</td>
</tr>
</tbody>
</table>

8.58 Where a special or unanimous resolution is taken in a meeting, rather than by written resolution, the exact numbers of people required to pass (or block) an amendment will depend on the number of unit owners who are present and voting. Figure 22 below illustrates how the number of votes required might vary for each threshold depending on how many unit owners turn up to vote in a hypothetical commonhold of 10 residential flats, where each flat has the same number of votes.

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<sup>43</sup> A “quorum” is the number of people (or percentage of the total votes) required to be present and voting in order for a decision to be valid.
For a hypothetical commonhold of 10 residential flats, where each flat has the same number of votes, to amend a local rule:

(1) If a special resolution is required:

<table>
<thead>
<tr>
<th>Number of owners turning up to vote</th>
<th>Number needed to vote in favour of change</th>
<th>Number needed to block change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum 20% quorum (2 unit owners)</td>
<td>2 unit owners</td>
<td>1 unit owner</td>
</tr>
<tr>
<td>5 unit owners</td>
<td>4 unit owners</td>
<td>2 unit owners</td>
</tr>
<tr>
<td>All 10 unit owners</td>
<td>8 unit owners</td>
<td>3 unit owners</td>
</tr>
</tbody>
</table>

(2) If a unanimous resolution is required:

<table>
<thead>
<tr>
<th>Number of owners turning up to vote</th>
<th>Number needed to vote in favour of change</th>
<th>Number needed to block change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum 20% quorum (2 unit owners)</td>
<td>2 unit owners</td>
<td>1 unit owner</td>
</tr>
<tr>
<td>5 unit owners</td>
<td>5 unit owners</td>
<td>1 unit owner</td>
</tr>
<tr>
<td>All 10 unit owners</td>
<td>10 unit owners</td>
<td>1 unit owner</td>
</tr>
</tbody>
</table>

(3) If 80% of all unit owners are required:

<table>
<thead>
<tr>
<th>Number needed to vote in favour of change</th>
<th>Number needed to block change</th>
</tr>
</thead>
<tbody>
<tr>
<td>8 unit owners</td>
<td>3 unit owners</td>
</tr>
</tbody>
</table>

8.59 As figure 22 above illustrates, which threshold is used will change the balance between how easy it is to change a local rule and how easy it is to block a change. In addition, this balance will be affected by whether a vote is carried out in a meeting or by written
resolution. In some cases the table shows that changes can be made with the participation of very few unit owners. It should be noted, however, that unit owners who do not turn out to vote, but who object to the change, may be able to restore the original position by putting forward a further resolution. Although not desirable, there is at least the opportunity for a previously apathetic majority to overrule a minority who have been able to pass a resolution.

8.60 Underlying the balance between the ease of changing a local rule, and the ability to block a change, is the tension between protecting the expectations of unit owners and their enjoyment of their property, whilst at the same time not making it impossible to change local rules in a commonhold. We have heard from a number of stakeholders that commonhold rules still need to be flexible enough to adapt to, for instance, new technologies and new demands. Below, we invite consultees to share their views as to which threshold should apply to amending the CCS.

A role for the Tribunal

8.61 A right to apply to the First-tier Tribunal (Property Chamber) in England, or in Wales the Residential Property Tribunal Wales, (“the Tribunal”) may also help to strike an appropriate balance between the competing aims considered above. For instance, the minority affected by a change on which they have been outvoted could be given the right to go to the Tribunal. This right could also be used to protect individual owners from being singled out: for instance, if the majority tried to introduce a rule preventing unit owners from owning pets and only one unit owner in fact had a pet. Below, we invite consultees to share their views as to when there should be a right to apply to the Tribunal in relation to amendments of the CCS. In Chapter 13 we consider the test which may be applied by the Tribunal and the remedies which may be available.

Distinguishing between local rules

8.62 There are a number of options for how any new threshold could be applied.

(1) A new, higher threshold could be introduced which applies to all local rules.

(2) Alternatively, some rules could be “entrenched” meaning that they require a higher threshold to be changed, whilst other rules could remain able to be amended by ordinary resolution. For instance, a rule banning pets might be entrenched, but a rule banning unit owners from hanging laundry outside might be open to amendment by ordinary resolution only. Under this option it could be left to each individual commonhold to state which threshold applies to each rule. Alternatively, a choice of thresholds could be provided, from which the individual commonhold would choose which threshold applies to each local rule.

8.63 Of these options, (2) allows for greater flexibility than (1), but at the cost of standardisation. Allowing each commonhold to set their own threshold, gives greater flexibility for each commonhold to tailor the CCS to suit their needs. However, conveyancing would be more complex if the risk of each local rule being changed needs to be assessed individually. One CCS could have 20 local rules, each requiring a different voting threshold to be met before it can be amended.

8.64 In any case, adding a new local rule should only be possible where it is approved by the same majority vote that would be needed to amend that rule later on. For instance,
if a new rule is being introduced that can only be amended by a special resolution, a special resolution should be needed to introduce that rule in the first place. However, questions remain over the level of certainty provided to unit owners on issues about which the CCS is silent at the point of purchase.

8.65 For instance, a unit owner may buy a unit subject to a CCS which makes no provision relating to pets. In the absence of a rule banning pets, unit owners would be allowed to keep pets. If the commonhold association then wanted to bring in a local rule banning pets, what voting threshold should apply? Under option (1), the answer is clear – the threshold which applies to all local rules. Under option (2), the answer will depend on what level of entrenchment the new rule is to have. Option (2) makes it harder for unit owners to calculate the risk, when buying the property (or getting a pet), that the rules regarding pets will change in the future.

8.66 One option to provide greater certainty for owners could be for legislation to set out a list of rules which will always require a higher threshold to introduce, for instance, rules regarding ownership of pets. However, determining which rules should be included on this list is not straightforward – what is important to one unit owner may be unimportant to another, and vice versa. Another option would be to encourage those setting up commonholds not to leave the CCS silent on important issues. Guidance could be set out recommending issues which it is sensible for a CCS to address from the outset.

8.67 To improve the position under the current law, we provisionally propose that a higher threshold for amending the CCS should be introduced. We invite the views of consultees as to what voting threshold should be required to amend local rules; what role should the tribunal have (if any); and whether the threshold should be the same for all local rules, or if rules should be differentiated. If consultees are of the view that rules should be differentiated, we invite views as to how the threshold for introducing a rule in an area on which the CCS is currently silent should be determined.
Consultation Question 38.

8.68 We provisionally propose that a higher threshold for amending the CCS should be introduced, which may apply to some or all local rules.

Do consultees agree?

8.69 We invite consultees’ views as to:

(1) what voting threshold should be required to amend local rules;

(2) when there should be a right to apply to the Tribunal in relation to amendments of the CCS; and

(3) whether the threshold should be the same for amending all local rules, or whether rules should be differentiated. If consultees are of the view that rules should be differentiated, we invite views as to how the threshold for introducing a rule in an area on which the CCS is currently silent should be determined.

Layout of the CCS

8.70 Currently, every CCS has to reproduce all the provisions of the model CCS as set out by the Commonhold Regulations, as well as any local rules applying to the particular commonhold. Whenever the Commonhold Regulations make changes to the model CCS, every commonhold’s CCS must be updated by the directors accordingly (these changes can be made by the directors without needing a resolution of the members), and the new CCS registered with HM Land Registry. The provisions set out by the Commonhold Regulations as mandatory will apply, regardless of whether or not those provisions are actually included in a commonhold’s specific CCS. This approach could potentially make it confusing for unit owners to understand their rights and obligations, if they have to check the legislation as well as the CCS.

8.71 An alternative approach was suggested by the Aldridge Report, where all the mandatory provisions are contained in regulations, and the CCS only sets out the local rules specific to that CCS. This approach is similar to that taken in New South Wales, where most of the rights and obligations of unit owners and the association are set out in legislation, and only the development-specific rules are set out in the documents for that specific commonhold.

8.72 Rather than requiring each CCS to repeat the provisions prescribed by the model CCS, it would be possible for each CCS simply to refer to the Commonhold Regulations, and set out only the local rules for that commonhold. Alongside this, there could be provisions requiring the commonhold association to give unit owners and purchasers a copy of the latest version of the regulations, so they are aware of their up-to-date duties.

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44 Aldridge Report, para 7.6.
8.73 This approach would reduce the cost and administration involved when the Commonhold Regulations are changed. It would remove the need for the directors to update and re-register the CCS at HM Land Registry every time the regulations are changed.

8.74 Additionally, this approach would make it easier to see exactly what the changes to the standard CCS are. As explained at paragraph 8.9 above, local rules must currently be added either in an annex at the end of the CCS, or at the end of each part or section. In practice, most of the current CCSs have added any local rules in an annex at the end. When this option is chosen, it is very easy to find all the rules specific to that commonhold. However, a number of the existing commonholds have chosen instead to put local rules at the end of each section. Consequently, the local rules are scattered in and amongst the mandatory provisions prescribed by the Commonhold Regulations. This approach makes it much harder to find all of the local rules in the CCS, particularly where there are a large number of such rules. If the CCS is changed so that it only sets out the local rules, it should always be easy to identify the provisions specific to that commonhold.

8.75 We provisionally propose that the standard provisions of the CCS should be contained in the regulations only, with the CCS then referring to those provisions and only the local rules spelt out in the CCS. We invite consultees’ views as to whether this amended layout should be complemented by a duty on the directors to provide unit owners with an up-to-date version of the standard provisions contained in the regulations when they change, and to issue an up-to-date version of the standard provisions, along with the CCS, to any new unit owner.

8.76 We think this option would: make it easier for potential purchasers to identify the provisions specific to that commonhold; make conveyancing easier and cheaper; facilitate changes made by secondary legislation; reduce corresponding work for HM Land Registry; and reduce the potential for inconsistencies.

**Consultation Question 39.**

8.77 We provisionally propose that the mandatory provisions of the CCS should be contained in the regulations, but not be reproduced in the CCS.

Do consultees agree?

8.78 If so, we invite consultees’ views as to whether the directors of the commonhold association should be under a duty to provide copies of the most up-to-date standard provisions contained in the regulations, along with a copy of the CCS, to any new purchasers, and should provide copies of the updated standard provisions to all unit owners as and when changes are made.

8.79 In Chapter 5, we provisionally propose that sections are adopted as a way to make commonhold workable for mixed-use and multi-block developments. Sections could potentially lead to a CCS being relatively long and complicated, even if the proposals discussed in Consultation Question 49 are adopted. To address this concern, we
provisionally propose that it should be possible to add schedules to the CCS, where the rights and obligations applying to a specific section can be collated. Unit owners would therefore only have to read one schedule to understand the rights and obligations specific to their section.

Consultation Question 40.
8.80 Should our provisional proposals to introduce sections be implemented, we provisionally propose that it should be possible to add schedules to the CCS, where the rights and obligations applying to a specific section can be collated.

Do consultees agree?

Other terms in the CCS
8.81 Throughout this Consultation Paper, we make provisional proposals which would require additional terms to be added (or existing terms to be amended) to the terms of the CCS prescribed by the Commonhold Regulations. For ease of reference, these are summarised in the table in Appendix 6.

8.82 We invite consultees’ views as to whether there are other terms which should be added to the prescribed terms of the CCS (that is, rules which should apply to every commonhold, rather than local rules which can optionally be adopted by individual commonholds). For instance, the prescribed terms could be reformed to include rules about minimum fire safety standards, or provisions requiring unit owners not to cause a nuisance to other unit owners.

Consultation Question 41.
8.83 We invite consultees’ views as to whether there are any new terms, other than those we have asked about in this Consultation Paper, which should be added to the prescribed terms of the CCS (that is, rules which should apply to every commonhold, rather than local rules which can optionally be adopted by individual commonholds).
Chapter 9: Management and maintenance issues

INTRODUCTION

9.1 In Chapter 7 we explain that the 2002 Act adopted the company limited by guarantee as the legal structure for the commonhold association. We provisionally proposed that the use of the company limited by guarantee should continue. Although some respondents to our Call for Evidence have suggested that it should be replaced, we take the view that many of the criticisms that are made of having a limited company are still likely to apply, even if a bespoke corporate structure were adopted.

9.2 In this chapter we consider some of the issues which may arise within the company law structure, and some general management issues. These include:

(1) appointment of directors;
(2) ensuring that directors carry out their duties;
(3) use of proxy voting;
(4) requirements for insurance;
(5) standard of repair of the building;
(6) rights of entry for maintenance;
(7) consent to alterations; and
(8) long-term contracts.

We consider each of these issues in turn, and make provisional proposals for reform in respect of them.

APPOINTMENT OF DIRECTORS

The current law

9.3 The law governing the appointment of directors of a commonhold association is partly to be found in the Companies Act 2006, and partly in the articles of association ("the Articles") of the commonhold association. The Articles are prescribed by regulations made under the 2002 Act, they are almost entirely standard for all commonholds, and there is limited scope to change them. When the 2002 Act was enacted, the Companies

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1 The Articles are to be found as the schedule to the Commonhold (Amendment) Regulations 2009 ("the Commonhold Amendment Regulations"), which replaces the articles of association which were prescribed in schedule 2 to the original Commonhold Regulations 2004. The Commonhold Amendment Regulations take account of various changes brought about by the Companies Act 2006, in particular the reduced role for the memorandum of association and the need to move most of the points which had to be contained in it into the articles of association. The Commonhold Amendment Regulations substitute (by reg 9) the schedule to
Act 1985 was in force. The Companies Act 1985 had been amended during the intervening years. More far-reaching amendments were then made by the Companies Act 2006.

Election of directors

9.4 The basic position under the Companies Act 2006 is that the directors of a company are elected by the members (that is, in the case of a commonhold association, the “unit owners”) in a general meeting. The 1985 Act, and earlier Companies Acts, required that directors should normally be elected at an Annual General Meeting (“AGM”), but the Companies Act 2006 has dropped the name and the universal requirement to hold a general meeting annually. The prescribed articles of association for a commonhold association have, however, retained the requirement to hold an AGM. Stakeholders have not suggested that the requirement to hold an AGM is unduly onerous. We consider that having an AGM does serve a useful function.

9.5 The Companies Act 2006 does not itself prescribe the method of election of directors: this matter is left to the articles of each individual company. Model articles of association for various categories of companies, including companies limited by guarantee, are prescribed by statutory instruments made under the Companies Act 2006. The model articles of association made under the Companies Act 2006 do not apply to commonhold associations. Instead, the articles of association for a commonhold association are prescribed in the Commonhold (Amendment) Regulations 2009 (the “Commonhold Amendment Regulations”), and its articles of association are required to comply with any commonhold regulations. If the prescribed articles of association are updated by regulation, the articles of association of all existing commonhold associations are automatically revised. Most, or perhaps all, of the existing commonholds will have been incorporated with the articles of association prescribed by the Commonhold Regulations 2004 (the “Commonhold Regulations”), but will now be operating under the articles of association prescribed by the Commonhold Amendment Regulations. To minimise the scope for confusion we describe the articles of association set out generally in regulations for the use of companies as “model” articles and those set out in regulations for commonhold associations as “prescribed” Articles.

9.6 The Companies Act 2006 requires a private company to have at least one director. As its articles may require it to have more, the model articles are drafted to allow for either eventuality. The prescribed Articles for a commonhold association are, however,
drafted on the basis that it will have at least two directors.\(^6\) No maximum number is prescribed. Article 47 nevertheless says that additional directors may be appointed by co-option, provided that the maximum number (if any) fixed by the Articles is not exceeded. ("Co-option" is where the directors themselves elect someone to join the board). This implicitly suggests that it would be permissible to include an additional article specifying a maximum number of directors. The Articles must contain all the provisions contained in what is now the schedule to the Commonhold Amendment Regulations,\(^7\) but additional provisions may be added provided that they are clearly identified,\(^8\) and do not contradict the prescribed Articles.\(^9\)

9.7 Under the general law\(^10\) directors are appointed by the members of a company at a general meeting\(^11\) by an "ordinary resolution".\(^12\) As directors are elected by a simple majority vote, a group of members which controls over 50% of the votes of the company will be able to ensure that only their nominees are elected as directors.\(^13\) This could be viewed as a structure which has a tendency to exclude minorities. None of the respondents to our Call for Evidence specifically criticised this position. However, some did refer to difficulties with boards of directors of leaseholder-controlled companies\(^14\) being dominated by a few assertive individuals.

9.8 The prescribed Articles for a commonhold association contain certain rather restrictive provisions. These include:

1. for directors to retire by rotation every three years;\(^15\) and
2. for new directors either to be "recommended" by the existing directors, or that notice of the proposed new director be given to the board at least 14 and not more than 35 days before the relevant meeting.

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\(^6\) Commonhold Amendment Regulations, sch arts 39 to 69.

\(^7\) Commonhold Regulations 2004, reg 14(1) and (2).

\(^8\) Commonhold Regulations 2004, reg 14(6).

\(^9\) Commonhold Regulations 2004, reg 14(1).

\(^10\) Provisions dealing with the appointment of directors are contained in the Companies Act 2006, ss 154 to 169.

\(^11\) This may be the AGM, which a commonhold association is still required to hold (see para 9.4), or it might be a general meeting called otherwise than as an annual meeting. The Companies Act 2006 no longer uses the term "extraordinary general meeting" for a meeting called otherwise than as the AGM.

\(^12\) An ordinary resolution requires either over 50% of the votes cast to be cast in favour if the vote is taken at a meeting, or over 50% of all votes in the commonhold to be cast in favour if the written resolution procedure is used. This majority is also known as a "simple majority".

\(^13\) It can be noted in passing that Companies Act 2006, s 160 requires that directors of a public company be voted on individually (and not elected by a single resolution as part of a "slate"), but this provision does not apply to private companies. s 160 still does not prevent a majority group from appointing all the directors. It is for this reason that our proposals for mixed-use commonholds include provisions for voting for directors by classes (see ch 5 para 5.39 onwards).

\(^14\) We use this term to include a residents' management company (RMC), a freehold management company (FMC) and a right to manage company (RTMCo): see the Glossary.

\(^15\) Commonhold Amendment Regulations, sch arts 41 and 42.
9.9 Similar provisions have appeared in many previous sets of model articles for private companies under the Companies Acts,\(^\text{16}\) and reflects the fact that many private companies are small family businesses. As they are in the model articles for private companies, very many leaseholder-controlled companies will also contain such provisions. The restrictive provisions referred to above have, however, been omitted in the currently prescribed articles for RTMCos.\(^\text{17}\) These articles follow the current model provisions for companies limited by guarantee generally. We consider in paragraphs 9.14 to 9.15 and 9.31 below whether the "recommendation" procedure should be retained.

9.10 It should perhaps be noted that the company law model for election of directors provides for a director (or a group or "slate" of directors) to be elected by resolution, which is either passed or defeated. There is no provision in the prescribed Articles (or indeed in the model articles for companies more generally) for a competitive election where, say, there are six candidates seeking election to four vacancies.

Removal and control of directors by the membership

9.11 A director can be removed, either by resolution at an AGM, or at another general meeting. Removal is by ordinary resolution, though there is a special procedure\(^\text{18}\) to ensure that statements for and against the resolution are circulated and the director(s) to be removed are given a chance to speak.

9.12 The general principle in company law is that the business of the company is to be conducted by the directors rather than the members,\(^\text{19}\) and this rule applies equally to commonhold associations.\(^\text{20}\) This principle is subject to a proviso (which, again, is found more generally)\(^\text{21}\) that it is "subject to any directions given by special resolution".\(^\text{22}\) This provision effectively allows a substantial majority of the members of a company to require the directors to take, or refrain from taking, any prescribed course of action.

\(^{16}\) Eg Arts 76 and 77 in Table A in the Companies (Tables A to F) Regulations 1985, SI 1985 No 805 (companies limited by shares). Table C – the model articles for companies limited by guarantee does not amend these provisions.


\(^{18}\) Companies Act 2006, ss 168, 169 and 312. This procedure is the "resolution with special notice" – not to be confused with a "special resolution".

\(^{19}\) Companies (Model Articles) Regulations 2008, SI 2008 No 3229, sch 2 art 3.

\(^{20}\) Commonhold Amendment Regulations, sch art 52.

\(^{21}\) Companies (Model Articles) Regulations 2008, SI 2008 No 3229, sch 2 art 4.

\(^{22}\) A special resolution requires either 75% of the votes cast to be cast in favour if the vote is taken at a meeting, or 75% of all votes in the commonhold to be cast in favour if the written resolution procedure is used.
Appointment of professional directors

9.13 There is no requirement that a director has to be a member of the commonhold association\(^23\) and, under the general law, it is possible for a director to be appointed on the basis that he or she would be remunerated for his or her services. It would therefore be possible, for example, to appoint a managing agent as a director. The director(s) would be appointed by a resolution of the members in the usual way. It would be necessary to agree beforehand that the person(s) appointed would enter into a contract with the association to be remunerated for their services. Being able to appoint paid directors might be useful if it were not possible to find a member to serve as a director.

Criticisms of the current law

Election of directors

9.14 As noted, the present procedure for electing directors includes what we have termed the “recommendation” procedure (which also includes a requirement for new directors to be nominated well in advance of any general meeting). Our Call for Evidence did not elicit any suggestion that the current system was causing any difficulties in practice. However, it was noted that boards of leaseholder-controlled companies could become dominated by a few assertive individuals. A similar issue could arise in commonhold associations.

9.15 The “recommendation” procedure was removed from the model articles for private companies\(^24\) when these were revised in 2008, and also from RTMCos when their prescribed articles were revised in 2009.\(^25\) It seems anomalous that the procedure was retained for commonhold associations when the prescribed Articles for these were revised in 2009. It also seems contrary to the democratic intentions of commonhold for the Articles to give the existing directors a measure of control over who else may be elected to the board.

Removal and control of directors by the membership

9.16 As noted in paragraph 9.12 above, the members of a commonhold association may give a binding direction to its directors on a specific issue if they pass a special resolution to that effect. We are aware that the use of this provision within a leaseholder-controlled company can cause ill-feeling and difficulties. If a group of members of a company can obtain a 75% majority of those present and voting, then they would also be able to get their nominees elected as directors.\(^26\) A resolution that binds the directors may appear to be an attempt by certain members to impose their views, without being willing to assume the responsibilities to which directors are subject. This does not, however, appear to be sufficient reason not to retain the ability of members to seek to bind the directors. Those who try to do so may be met with the response that, if they wish to impose their views, they should undertake the responsibility of being directors.

\(^23\) Commonhold Amendment Regulations, sch art 40.

\(^24\) Both companies limited by shares and companies limited by guarantee.

\(^25\) In 2011 for Wales: see n 17.

\(^26\) Directors can be elected by a simple majority.
9.17 The powers of the directors are, however, also circumscribed by the fact that many important decisions relating to the commonhold will in fact (by statute or the commonhold community statement (the “CCS”)) require the consent of a majority of the membership, or the consent of the owner(s) of the unit(s) directly affected. The consent of those with a charge registered against the unit may also be needed. These matters are considered in Chapter 8. The consents required for the most significant changes are as set out in Chapter 8, figure 20 at paragraph 8.15.

9.18 We are not aware of any general dissatisfaction with the principle that the affairs of the commonhold are to be conducted by the directors. Some respondents to the Call for Evidence, and other commentators, have suggested that the commonhold contributions should be confirmed by being approved by an affirmative vote of the members of the commonhold association (that is, the unit owners). This issue is considered in paragraphs 10.20 onwards, and 10.32 onwards in Chapter 10, and we propose there that an affirmative vote of the members should be required.

9.19 Apart from the difficulties identified in paragraphs 9.16 above, we are not aware of any problems surrounding the removal of directors and the exercise of control over them. As the difficulties that we describe are principally problems with personal relationships within the commonhold, we do not attempt to offer any legal solution.

Difficulties in getting members to serve as directors

9.20 Some respondents to the Call for Evidence have drawn our attention to the difficulty in getting members to serve as directors of leaseholder-controlled companies, and have suggested that similar difficulties would be experienced within commonhold. Some have also suggested that it is particularly difficult to get members with professional qualifications and experience which might be useful for the running of the company – such as lawyers, accountants, architects and building surveyors. It is suggested that they are deterred from serving because they would be held to the higher standard of competence expected from a professional person, even though they are not being remunerated for their services.

9.21 While we acknowledge these concerns, we do not think that it is viable to make proposals for law reform. It is not going to be practicable to deem individuals not to have the qualifications and experience which they clearly do have. To require a court to take into account the fact that they are unpaid does not really address the issues. Further, any change would mark a departure from the general scheme adopted by the Companies Acts.

9.22 One solution to the inability to find members willing to serve as directors is for the unit owners as the members of the company to appoint paid directors. While no specific points have been raised with us about the ability to appoint paid directors, we have some concerns about how the current arrangements might work in practice. We note

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27 The principal examples of provisions of this kind are conveniently set out in figure 20 at 8.15 in ch 8.

28 This term is used in this Consultation Paper to include both the “commonhold assessment” and the “reserve fund levy”, which together correspond to the service charge which usually forms part of any residential long leasehold scheme.

29 Companies Act 2006, s 174(2)(b).
that, as far as we are aware, none of the current commonholds have appointed paid directors, therefore there is no direct evidence of current practice.

9.23 In principle, to appoint professional directors the members would simply resolve to appoint named individuals. It seems to us that two broad models could be adopted. One would be for the commonhold association to elect as directors professional persons who were experienced in running a company in accordance with the law, but were not experienced managing agents, such as solicitors, accountants, or qualified company secretaries. They would then appoint managing agents to carry out day-to-day management. This approach would mean, however, that the association would be bearing the cost of having professional persons both as directors and as managing agents.

9.24 The alternative would be to appoint the managing agents as the directors. On balance, it seems more appropriate for the professional directors to be persons who are experienced in managing property. They would then not only carry out the day-to-day management, but be able to make strategic decisions: for example, whether to go in for an extensive programme of renewal and replacement, or to undertake “patching” repairs.

9.25 However, we understand that most managing agents practise as limited companies, or perhaps limited liability partnerships, rather than under the form of a traditional partnership. Under the current law a company (or LLP) might be appointed as one director, and a director of that company (or an individual member of the LLP) could be appointed as an additional director. However, that would not really offer the safeguards intrinsic in having two directors.

9.26 The situation will be changed when section 87 of the Small Business, Enterprise and Employment Act 2015\(^{30}\) is brought into force. That section requires that all company directors be natural persons: in other words, human beings rather than “legal persons” such as companies. That would mean that, if a managing agent which operated as a limited company was to be appointed, it would not be possible to appoint the company itself as the director. Instead, two or more named individuals from the company would need to be appointed. These directors would, in turn, appoint their own company to act as the managing agent. This outcome appears satisfactory, provided that any professional indemnity insurance taken out by the company also covers any acts taken by the directors personally as directors of the commonhold association.

9.27 We are also concerned at the possibility of a commonhold association being left without any directors at all; for example, where directors have resigned or died and no new director is appointed. If there are no directors, then the commonhold association will be struck off the register at Companies House. For reasons which are explained elsewhere we consider it essential for the proper functioning of a commonhold that the association should continue in existence, if at all possible.\(^{31}\)

\(^{30}\) The section repeals the Companies Act 2006, s 155, and inserts new sections 156A, 156B and 156C into the Companies Act 2006.

\(^{31}\) Ch 7 para, 7.17 onwards.
9.28 We hope that if a commonhold association is at risk of being left without directors, members will be willing to serve, even if they accept appointment as directors primarily to appoint and supervise managing agents. An incentive would be that, if they fail to find directors, they might find it difficult to sell their commonhold units.

9.29 If no member were prepared to serve as director, we would expect that members would at least take steps to find individuals likely to serve as directors on a professional basis, and ensure that they were elected by an ordinary resolution.32

9.30 We would expect that, by one or other of these means, most commonhold associations would be able to ensure that they had at least the required minimum of two directors. Therefore, we expect that instances where a commonhold association is left without directors will be rare. Notwithstanding, we consider below whether a “back-stop” provision should be introduced to deal with this possibility.

Proposals for reform

Election of directors

9.31 In the interests of a more open and democratic procedure, we provisionally propose that the procedure for the election of directors of a commonhold be simplified, so that the prescribed Articles simply provide that directors should be elected at a general meeting, and also may be co-opted by the existing directors (see paragraph 9.6 above).

Consultation Question 42.

9.32 We provisionally propose that the procedure for the election of directors of a commonhold should be simplified, so that the prescribed articles of association provide that directors should be elected at a general meeting, and also may be co-opted by the existing directors.

Do consultees agree?

Difficulties in getting members to serve as directors

9.33 We consider that, if a commonhold cannot find members able and willing to serve as directors, and the commonhold association refuses then to appoint professional directors, any member of the association, or anyone with a charge over a unit, should be able to apply to the First-Tier Tribunal (Property Chamber) or Residential Property Tribunal Wales (together referred to as the “Tribunal”). On an application, the Tribunal should be able to appoint suitable professional persons as directors, who would hold office until the association appointed directors (whether lay or professional) in the usual way.

9.34 Although we recognise that this step is unusual and serious in terms of company law, we consider that the Tribunal would have the necessary experience and expertise to undertake the role. The same principles and considerations would apply as when the

32 This could be done at a General Meeting or by the written resolution procedure.
Tribunal is called upon to appoint a receiver and manager under Part II of the Landlord and Tenant Act 1987.\textsuperscript{33}

9.35 In practice, if an application is made to the Tribunal for the appointment of directors, this application may prompt the membership of the commonhold association to take responsibility themselves. They might well prefer to make this decision themselves, rather than having the matter taken out of their hands by the Tribunal. At the end of the day the Tribunal might very rarely have to appoint directors, but having a “back-stop” procedure available might assist in ensuring that one does not get to the point where it is actually needed.

**Consultation Question 43.**

9.36 We provisionally propose that, if a commonhold association cannot find members able and willing to serve as directors, and is also unwilling to appoint professional directors, any member of the association should be able to apply to a court or tribunal for professional directors to be appointed, who would then be paid by the association.

Do consultees agree?

9.37 We provisionally propose that, if members should be able to make such an application, then someone with a mortgage or other charge over a unit should also be able to do so.

Do consultees agree?

9.38 We provisionally propose that, if it should be possible for an application to appoint directors to be made, it should be heard by the First-tier Tribunal (Property Chamber) (in Wales, the Residential Property Tribunal).

Do consultees agree?

**THE DUTIES OWED BY DIRECTORS, AND ENSURING COMPLIANCE**

**The current law**

9.39 Directors of a commonhold association owe the same duties as any other company directors. These have evolved through case law over a long period of time, but have now been brought together as sections 170 to 182 of the Companies Act 2006. The duties may be summarised as follows:

1. to act within their powers;\textsuperscript{34}

2. to promote the success of the company;\textsuperscript{35}

\textsuperscript{33} This procedure is discussed further at para 9.45 and following, below.

\textsuperscript{34} Companies Act 2006, s 171.

\textsuperscript{35} Companies Act 2006, s 172.
(3) to exercise independent judgment;\(^{36}\)

(4) to exercise reasonable care, skill and diligence;\(^{37}\)

(5) to avoid conflicts of interest;\(^{38}\)

(6) not to accept benefits from third parties;\(^{39}\) and

(7) to declare any interest in a proposed transaction or arrangement.\(^{40}\)

9.40 All of these duties may, in principle, apply to the directors of commonholds, though some are more likely to arise in practice than others. It should be noted that these duties are owed to the company, and not to its individual members. If a unit owner as a member of the commonhold wishes to allege that a director should be held liable for a breach of any duty, he or she would have to obtain the permission of the court to take proceedings against the director in the name of the commonhold association.\(^{41}\)

9.41 The commonhold association will owe the duties to the individual unit owners which are set out in the CCS.\(^{42}\) Regulations may then make provision for the enforcement of those duties by a court,\(^{43}\) which for these purposes also includes a tribunal.\(^{44}\) As the duties owed to the unit owners under the CCS are owed by the association, rather than by the directors personally, any proceedings by a unit owner alleging breach of a duty owed to him or to her would have to be taken against the association.

**Criticisms of the current law**

9.42 Based on the limited experience of the few commonholds already in existence, we are not aware of any problems that have been encountered where unit owners have had difficulties in forcing directors to carry out their duties of management and repair. From the experience of FMCs and RMCs within leasehold, however, we are concerned that problems might occur where either a single owner, or a number of owners acting in concert, are buying up the units in a commonhold with a view to redevelopment.

9.43 Anecdotal evidence suggests that a particularly difficult situation may arise where those who are buying up the units control a majority of the votes\(^{45}\) in the commonhold

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\(^{36}\) Companies Act 2006, s 173.

\(^{37}\) Companies Act 2006, s 174.

\(^{38}\) Companies Act 2006, s 175.

\(^{39}\) Companies Act 2006, s 176.

\(^{40}\) Companies Act 2006, s 177.

\(^{41}\) The proceedings would be by the special company law procedure known as the *derivative action*: see Companies Act 2006, ss 260 to 264.

\(^{42}\) CLRA 2002, s 31(1).

\(^{43}\) CLRA 2002, s 37. This has been done by the Commonhold Regulations 2004, reg 17.

\(^{44}\) CLRA 2002, s 66(3).

\(^{45}\) It should be noted that, if the votes are not allocated equally, the owner of a minority of the units may control over 50% of the votes. References to “the owner of a majority of the units” should be read as including this situation, as well as the situation where a number of associated owners are acting in concert.
association and can, in effect, run the commonhold in their own interests. The owners of the majority of the units may then try to make life difficult for the minority. They will be able to appoint the directors. The directors may refuse to keep the building in proper repair. Even if an injunction (a court order to do, or not to do, something) is made against the directors, they may comply with its terms, but then decline to carry out further repairs. The minority owners will have no alternative but to sell up to the majority for whatever they will offer. Because of the lack of repair, and the ongoing disputes, it will be difficult to find anyone else willing to buy the units.

9.44 Within a commonhold, an individual unit owner who met with a similar situation could apply to the court for an injunction requiring the commonhold association to comply with its repairing obligations.\textsuperscript{46} An injunction could be made against the association, and it could be served on the directors as its officers. It is, however, notoriously difficult to enforce a “mandatory injunction” (a court order requiring someone actively to do something), especially an injunction requiring repairs, because it is difficult for the court to monitor whether it is being performed.

9.45 Because of the difficulty in framing and enforcing mandatory injunctions to repair against landlords, the courts through case law established that, in the case of a leasehold development, the court may appoint a receiver and manager to carry out the functions of the landlord.\textsuperscript{47} This was then placed on a statutory basis in Part II of the Landlord and Tenant Act 1987.\textsuperscript{48} We provisionally take the view that some broadly equivalent procedure is likely to be needed in commonhold.

Proposals for reform

9.46 It is inherent in the idea of commonhold that decisions will be made by the majority; such a general provision is essential for the smooth functioning of the commonhold. We recognise, however, that some restrictions may have to be imposed on the majority if they use their power in an oppressive manner. Although a unit owner who was adversely affected by this oppressive behaviour would be entitled to take court proceedings to enforce the duties owed by the commonhold association, it might prove difficult and expensive to take repeated proceedings for mandatory injunctions, and then to enforce them.

9.47 It seems to us that the scenario described in paragraph 9.43 above is similar to the situation which, in the leasehold context, would be dealt with under Part II of the Landlord and Tenant Act 1987. This Act allows a leaseholder to apply to the Tribunal for the appointment of a receiver and manager to take over the functions of the landlord (and any management company). The basis of such an application is that the landlord

\textsuperscript{46} The Commonhold Regulations 2004, sch 3, para 4.5.1 requires the association to repair and maintain the common parts, and any purported amendment to derogate from this would be void.

\textsuperscript{47} This was recognised in the case of \textit{Daiches v Bluelake Investments Ltd} (1985) 17 Housing Law Reports 543, where the court appointed a receiver and manager to undertake repairs which the landlord was clearly unwilling to carry out. In the earlier case of \textit{Hart v Emelkirk} (1982) 9 Housing Law Reports 114 a receiver and manager had been appointed where a landlord was absent.

\textsuperscript{48} When enacted, the Landlord and Tenant Act 1987 gave this power to the court. It was transferred to what was then the Leasehold Valuation Tribunal (now in England the First-tier Tribunal (Property Chamber)) by the Housing Act 1996.
(or management company) is in breach of its obligations under the lease, and that it is just and convenient to make an appointment.\textsuperscript{49} We do not think it would be appropriate for a manager to be appointed to take over control of the commonhold association, as the directors would remain responsible for the financial accounting of the association, and the making of the annual "confirmation statement" to Companies House.\textsuperscript{50} There would thus be an unfortunate division of responsibilities.

9.48 If the directors of the commonhold association were refusing to carry out repairing obligations, then we would expect that, in the first instance, the unit owner affected would apply to the court or to the Tribunal for an injunction. If, however, the directors persistently failed to comply with the CCS in some material respect, we provisionally propose that the unit owner affected should be able to apply to the court or the Tribunal to appoint directors so as to protect the interests of the minority. These might include director(s) drawn from the minority membership, and/or independent directors, including professional directors, if necessary. This power would need to be supplemented by the power to make supplementary orders so as to ensure, for example, that:

\begin{enumerate}
\item the directors appointed to protect the minority could not be removed by a resolution passed by the majority;
\item the members did not attempt to override or frustrate the decisions of the new board of directors by passing special resolutions requiring the directors to take, or not to take, any specified action;\textsuperscript{51} and
\item the members of the association did not attempt to override or frustrate the decisions of the new board by failing to approve a budget and contributions to shared costs which was intended to remedy any disrepair or other lack of necessary expenditure.
\end{enumerate}

9.49 In general, we are proposing that disputes within commonholds should go to the Tribunal rather than to the court.\textsuperscript{52} The situation here could be considered to be rather different, in that we are proposing that directors should be appointed, in effect, to take control of a company. We nevertheless incline towards applications being made to the Tribunal, given their experience of dealing with applications for an appointment of a receiver and manager in the leasehold context.

9.50 We recognise that these proposals mark a far-reaching intrusion into the normal workings of a company, but we provisionally take the view that the problem needs to be addressed if owners of commonhold units who find themselves subject to the deliberately oppressive decisions of a majority are to have effective forms of redress. Given the difficulty in ensuring that someone complies with a court order to carry out repairs (outlined at paragraph 9.44 above) we consider that some more effective remedy should be made available.

\textsuperscript{49} Landlord and Tenant Act 1985, s 24(2).
\textsuperscript{50} Formerly the "annual return".
\textsuperscript{51} As outlined at para 9.12 above.
\textsuperscript{52} We have previously suggested that the Tribunal should have power to appoint directors in certain circumstances: see paras 9.33 to 9.35 above.
Consultation Question 44.

9.51 We invite consultees’ views as to whether a problem is likely to arise whereby a single investor, or a group of investors, who own a majority of units, run a block in their own interests in order to “squeeze out” other owners.

9.52 If it is felt that problems are likely to arise, then we invite consultees’ views as to the following:

(1) whether the concept of “persistent failure to comply with the CCS in some material respect”, offers a satisfactory basis upon which a court or tribunal could intervene on an application by a unit owner;

(2) whether such applications should be made to the court or the Tribunal;

(3) whether, the court or Tribunal should have the power to appoint directors, and to make the supplementary orders set out in paragraph 9.48 above, should they be required;

(4) whether it would be necessary for the court or tribunal to exercise continuing supervision over the directors who were appointed; and

(5) whether other solutions could be used to address the difficulty.

USE OF PROXY VOTING

The current law

9.53 The prescribed Articles permit proxy voting. This is where a member authorises another person to vote on his or her behalf. Members who have given a proxy in writing to another person (who will often in practice be a director), are treated as being present and thus as contributing towards a quorum at a general meeting. Proxy voting serves a useful purpose in ensuring that those who are unable physically to attend a meeting may play their part in making decisions.

Criticisms of the current law

9.54 Although proxy voting serves a useful function, anecdotal evidence from leaseholder-controlled companies suggests that it is potentially open to abuse. Proxy voting may be organised to favour the sitting directors in that they – or perhaps the managing agent – are well placed to collect proxies from members who are apathetic about attending a meeting, but are willing to sign a proxy form. They thus have an advantage over any group of members who may oppose the current directors.

Proposals for reform

9.55 We think that proxy voting is a useful mechanism to retain, partly because it is an established part of company law, and also because the growth of “buy-to-let” will mean that many unit owners may find it difficult to attend general meetings. It is possible that the chair of the directors, or an individual director, to collect numerous proxies could be
thought to make proxy voting open to abuse. If so, then a rule might be adopted to restrict the number of proxies that any individual (whether a director, another member, or a non-member) could be given. Such a rule is not generally adopted within company law.

9.56 We are, however, concerned that the use of proxies may be open to abuse in some situations. For example, developers may insist that purchasers sign a proxy so that the developers can maintain control of the development. There is also a risk that lenders will seek a proxy as a means of protecting their security. However, the risk of abuse seems relatively slight. In Chapter 6, we have made provisional proposals to ensure that developers have sufficient flexibility to achieve their aims, and we hope that these proposals, if adopted, would remove any incentive for developers to seek to obtain proxy votes. We also recommend at paragraph 6.63(6) a general anti-avoidance provision which would prevent the use of proxies in this way. In relation to lenders, it seems to us that they are unlikely to want to be involved in the management of commonholds.

9.57 In order to decide whether restrictions on proxy votes are required, we think it would be useful to have further evidence of how the use of proxies works in leaseholder-controlled companies. We would also like to hear consultees’ views on whether they think there are risks of abuse and, if so, where those risks are most likely to arise.

Consultation Question 45.

9.58 We seek consultees’ views on whether their experience with other leaseholder-controlled companies (Freehold Management Companies, Residents’ Management Companies and right to manage companies) leads them to believe that provisions for proxy voting may be abused, and, if so, in what way or ways.

9.59 We further seek consultees’ views on whether any such abuses could be prevented or mitigated by:

(1) a restriction on the number of proxy votes that any individual might hold; or

(2) some other device (please specify).

REQUIREMENTS FOR INSURANCE

Introduction

9.60 Within any commonhold, there will be a need for the commonhold association to take out various forms of insurance. Although there is no reason why individual unit owners should not insure the contents of their flats or houses, and any insurance for liabilities that they incur for accidents on their premises, the experience of blocks of leasehold flats suggests that it is much more satisfactory for the building itself to be insured by a single policy. This experience also suggests that there should be insurance in place to cover potential liability for any accidents which the unit owners, their visitors, and any other persons may sustain whilst on the common parts.
9.61 Any prudent homeowner will take out insurance against fire, and certain other risks. The need for the buildings of the commonhold to be insured against damage by fire and other risks is self-evident. How this need is best met is considered below in paragraphs 9.81 to 9.86.

9.62 Public liability insurance is a particularly important issue. In some other jurisdictions, a failure to insure, or underinsurance, has led to the potential insolvency of the body corporate when faced with a catastrophic claim. In view of the serious consequences of insolvency we are keen to minimise the risk of its happening.

9.63 An obvious way to minimise the risk of a catastrophic claim rendering the commonhold association insolvent is to require that it take out insurance to an appropriate amount. Insurance against two eventualities will need to be considered:

(1) occupiers’ liability insurance, to cover any claim by a unit owner, visitor or trespasser who, as a result of the negligence of the association, sustains personal injuries whilst visiting the common parts of the commonhold; and, additionally

(2) more general public liability insurance may be required to cover any claims from those who, whilst not visiting the commonhold, incur injuries (for example, a passer-by who is hit by a falling part of the building). This type of insurance can be termed “property owner’s liability insurance”.

9.64 We understand that many leaseholder-controlled companies take out directors’ and officers’ insurance as a matter of course. This insurance ensures that individual directors are indemnified against (that is, covered for) any claims which may be made against them personally. We understand that this insurance is fairly readily available at low cost.

The current law

Buildings insurance

9.65 The 2002 Act specifically requires the CCS to “make provision imposing duties in respect of the insurance, repair and maintenance of each commonhold unit”, but does not specify the nature of the insurance required, or who has to take it out. The CCS supplements this section by requiring the commonhold association to insure the common parts. The level of insurance required is specified to be “to their full rebuilding and reinstatement costs against loss or damage by fire and such other risks as are specified in paragraph 5 of Annex 4”. Basic fire insurance is therefore the baseline in the prescribed CCS. Additional risks may be specified as a local rule, and can be tailored to the insurance which is available and appropriate in local circumstances.

54 CLRA 2002, s 14(2).
55 Commonhold Regulations 2004, sch 3, para 4.4.1.
Government guidance on the drafting of a CCS, published by the Department for Constitutional Affairs,\(^{56}\) contains suggested wording for this paragraph.\(^ {57}\)

9.66 The thinking behind requiring only basic fire insurance, and making all other risks the subject of a local rule, would appear to be that basic fire insurance should always be available, but that cover for risks such as flood, subsidence, and heave may be difficult to obtain in certain areas.\(^ {58}\) Requiring that insurance should always be taken out against risks such as these might therefore impose a requirement that is impossible to fulfil.

9.67 The standard modern practice\(^ {59}\) with leasehold flats is that the buildings insurance for the whole building is taken out by the landlord, and the intention of the current requirement in the CCS appears to be that the commonhold association assumes equivalent responsibility in a commonhold. The nature of commonhold, however, means that this is not an exact parallel. Whereas the landlord owns the reversion of each flat, and thus has an insurable interest\(^ {60}\) in the whole building, the commonhold association owns only the common parts. Although these will include the roof, and main structure, including the external walls, the remaining parts of the building within the unit will belong to the unit owner, and the association will have no interest in them. The Commonhold Regulations address this issue, by imposing a duty on the commonhold association to insure the whole building.\(^ {61}\)

9.68 The prescribed CCS does not provide for the owner of a unit to be entitled to verify both that the policy is on foot, and also to obtain a copy of the policy. Further, there is no right for the interests of unit owners, and their mortgage lenders, to be noted on the policy. These are issues which are currently left to local rules.\(^ {62}\) A stronger case might be made for including at least the verification of cover, and provision of a copy policy, to unit owners, as that will be required in any commonhold, and will not be dependent upon local conditions.

9.69 If the commonhold consists of free-standing (or vertically-divided) units, then the CCS must still make provision for insurance,\(^ {63}\) but Regulation 15(7) (see above) will not

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56 The Department for Constitutional Affairs is now part of the Ministry of Justice.

57 Commonhold: Guidance on the drafting of a Commonhold Community Statement including Specimen Local Rules (Department for Constitutional Affairs, December 2004), para 68.

58 We understand that cover for leasehold flats against flood damage is not available under the Flood-RE scheme, as the insurance is considered to be a commercial, rather than a residential, policy. It is not clear whether this would therefore be a problem with commonhold units.

59 Older leases are occasionally encountered where each flat is insured individually by the leaseholder. This is not generally considered satisfactory – except with maisonettes – and would form the basis to have all the leases in a block varied on the application of a single leaseholder, or the landlord, under Landlord and Tenant Act 1987, s 35(2)(b).

60 This is a general principle of insurance law, and essentially means that you can insure only what you own, or have some other legal interest in.


62 A local rule is a provision in the CCS which is specific to that particular commonhold, rather than one which is required by law to apply to all commonholds. A suggested form of wording is to be found in Commonhold: Guidance on the drafting of a Commonhold Community Statement including Specimen Local Rules (Department for Constitutional Affairs, December 2004), para 72.

63 Under CLRA 2002, s 14(2).
apply. The obligation to insure the units can therefore be cast on the commonhold association or the unit owners, as seems more appropriate. The expectation seems to be that houses and other free-standing or vertically-divided buildings will be separately insured by the unit owners. There would, however, be nothing to prevent the CCS from requiring a commonhold association to insure free-standing buildings, or vertically-divided buildings: say, a terrace of town-houses.

Public liability insurance

9.70 The 2002 Act and the Commonhold Regulations made under it (including the prescribed CCS) do not require that public liability insurance (by which is meant both occupier’s liability insurance and property owner’s liability insurance) be taken out by the commonhold association, or indeed by the unit owners. It would seem that those who drafted the 2002 Act and the Commonhold Regulations were concerned that such insurance would not necessarily be generally available, and so a requirement to obtain this insurance may be impossible to fulfil.

Directors’ and officers’ insurance

9.71 There is currently no requirement made in the 2002 Act or the Commonhold Regulations for a commonhold association to take out directors’ and officers’ insurance on behalf of its directors. There is no reason why this requirement could not be imposed by a local rule. Even if there is no requirement in the CCS that a commonhold association take out directors’ and officers’ insurance, there would seem to be nothing to prevent the board of directors from taking out such a policy in pursuance of its general power to manage the commonhold.

Criticisms of the current law

Buildings insurance

9.72 We are not aware of any particular problems that have arisen with the arrangements to insure commonholds against fire. Most unit owners will expect insurance against a wider range of risks to be taken out, though we accept that it is difficult to require this as it might not be possible to obtain more comprehensive insurance in all localities. It does, however, seem to us that within any commonhold there will be a need for unit owners to be supplied with details of the insurance cover which the commonhold association has taken out. The unit owners will also need to be able to verify that the cover is currently in place.

9.73 An additional issue arises with buildings insurance. We have noted at paragraph 9.65 above that the CCS requires the commonhold association to insure the common parts. We have also noted at paragraph 9.67 above that, in a block of flats, the commonhold association owns the roof, and main structure, including the external walls, but the remaining parts of the building will belong to the individual unit owners. These would include any non-loadbearing wall within a unit, and also any fixtures, such as bathroom

64 The model articles for companies limited by guarantee do, however, include a permissive power for the company to take out such insurance: Companies (Model Articles) Regulations 2008, SI 2008 No 3229, sch 2 art 39.

65 The Commonhold Regulations 2004, reg 9 refers to buildings which are not detached or vertically divided, but for simplicity we shall refer to blocks of flats.
installations, a fitted kitchen, and any fitted wardrobes. The Commonhold Regulations attempt to get over this difficulty by requiring the commonhold association to insure the whole of the building, both the common parts that are owned by the association, and the parts that are owned by the unit owners. Although the intention behind this statutory requirement may have been to give the association an insurable interest in the parts of the building owned by the unit owners, it may not have been successful in doing so. It seems desirable that the matter should be put beyond doubt. The validity of requiring the association to insure buildings which did not belong to it would also need to be established if the CCS required the commonhold association to insure free-standing buildings, or vertically-divided buildings.

9.74 The requirement in the CCS that the commonhold association insures the whole building means that it must insure parts of the building which it does not own. The fact the commonhold association does not own parts of the building could mean that an insurance company might be entitled to refuse to pay out on the policy, on the grounds that the association was insuring something which it had no insurable interest in.

9.75 The Law Commission has described insurable interest as the requirement that the party taking out the insurance “must stand to gain a benefit from the preservation of the subject matter of the insurance or to suffer a disadvantage should it be lost”.

9.76 Buildings insurance policies are contracts of indemnity. They insure the policyholder against losses suffered as a result of damage or destruction to the building. In indemnity insurance, the requirement for insurable interest can be satisfied by showing that the policyholder will suffer a detriment should the insured event occur. The indemnity principle permits the policyholder to recover only the amount of their actual loss.

9.77 The CCS imposes an obligation on the commonhold association to use the proceeds of any insurance policy to rebuild or reinstate the common parts. The CCS does not, however, impose any obligation on the association to rebuild or reinstate the parts of the building which it does not own. This would technically form part of the building, and not fall within a “home contents” policy, which would typically cover only chattels.

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66 These would technically form part of the building, and not fall within a “home contents” policy, which would typically cover only chattels.


68 See n 60 above.

69 See para 9.69 above.

70 Similar issues arise when a right to manage company wishes to insure a block of flats, as it is proposing to insure a building which it does not own. The issues will be considered in the forthcoming Law Commission Consultation Paper on the Right to Manage.


73 See for example Lucena v Craufurd (1806) 2 Bos & PNR 269 at 302.


75 Commonhold Regulations 2004, sch 3 para 4.4.2.
the building owned by the individual unit owners. These obligations might be included as local rules, but could get overlooked.\textsuperscript{76}

9.78 Imposing an obligation to reinstate and/or to rebuild might prove crucial to the commonhold association being able to claim under the insurance policy for damage to or destruction of the parts of the units belonging to the unit owners. The existence of this obligation is likely to give the association an insurable interest in the units, even if it does not own them. The same obligation also satisfies the indemnity principle. For insurance purposes, a loss must leave the policyholder “financially poorer than before”.\textsuperscript{77} If the association failed to rebuild and reinstate the building, including the parts of the units owned by the unit owners, it would be financially liable to the unit owners.

Public liability insurance

9.79 The lack of any requirement for the commonhold association to take out public liability insurance in respect of the common parts does seem to us to be a deficiency in the current legislation, especially in view of the fact that other jurisdictions have experience of catastrophic loss claims arising whilst the commonhold is uninsured or underinsured. As we explain in Chapter 7, paragraph 7.14, the consequences of such a claim are particularly serious if they are likely to make the commonhold insolvent, with all the complications that result from that.

Directors’ and officers’ insurance

9.80 Many respondents to our Call for Evidence pointed out that it was becoming increasingly difficult to get members to serve as directors of leaseholder-controlled companies. The implication of this is that it might be equally difficult to get members to serve as directors of commonhold associations. If they know that they have the benefit of directors’ and officers’ insurance, it seems reasonable to assume that they may be more willing to serve.

Proposals for reform

Buildings insurance

9.81 We have provisionally concluded that it is not appropriate to require that commonhold associations take out more comprehensive cover than basic fire cover, because cover for certain risks will not be available in some areas. Local rules should, however, require more comprehensive cover wherever this is practicable.

9.82 Certain requirements relating to insurance are likely to be required in all commonholds. In the interests of standardisation, and to ensure that practice is consistent across commonholds, we provisionally propose that the CCS should be amended so as to require that:

\begin{itemize}
\item \textsuperscript{76} Commonhold Regulations 2004, sch 3 para 4.6.1.
\item \textsuperscript{77} Clarke, MA \textit{Law of Insurance Contracts} (5\textsuperscript{th} ed 2006) ch 16-2A.
\end{itemize}
either a copy of the buildings policy and schedule, or sufficient details of it, should be supplied to all unit owners on or before they acquire a unit, and whenever the terms of the policy change; and

the association should confirm to unit owners and their mortgage lenders that the insurance is in existence on an annual basis, and when reasonably required at other times.\(^78\)

We think that any difficulties in the commonhold association being able to obtain insurance over common parts that are owned by units should be resolved by making express provision in the legislation. We provisionally propose that legislation should state that the commonhold association is deemed to have an insurable interest in the parts of the building which were owned by the unit owners. This provision would expressly allow the association to insure any building to cover the cost of reinstating all of it. In Scotland, owners’ associations, which are bodies corporate responsible for the management of a development, are presumed to have an insurable interest in the development or any part of it.\(^79\)

It is arguable that it might not be sufficient to provide that the commonhold association is deemed to have an insurable interest in the parts of the building owned by the unit owners. An insurance company might still try to argue that the association had not sustained any actual loss.\(^80\) We consider this argument can be addressed by further providing that the association should be under an obligation to reinstate or rebuild the whole building.

We do not think it would be of assistance to provide that the commonhold association should insure the whole building in the joint names of the association and the unit owners. In many commonholds there would simply be too many unit owners for them all to be named on the policy. The policy would have to be repeatedly updated, as units changed hands.

Noting the unit owners’ interests on an insurance policy taken out by the commonhold association will not make them a party to the insurance contract.\(^81\) It does not give the unit owners a right to enforce the insurance policy in their own right if, for example, the association was found for any reason to be unable to claim. We are aware that many standard insurance policies issued specifically for blocks of flats state that the interests of leaseholders and their mortgage lenders are “automatically noted”. Policies intended for commonhold could well do the same for unit owners and their lenders. We do not, however, think that this addresses the issues of “insurable interest” and the “indemnity principle” that we have identified.

\(^{78}\) Eg, if a unit owner is re-mortgaging a unit.

\(^{79}\) Title Conditions (Scotland) Act 2003 (Development Management Scheme) Order 2009, sch 1 para 3(2)(c).

\(^{80}\) This is an application of the “indemnity principle” which is explained at paras 9.76 to 9.78 above.

\(^{81}\) Colinvaux’s Law of Insurance (11th ed 2017), para 15-024.
Consultation Question 46.

9.87 We provisionally propose that legislation should deem that the commonhold association has an insurable interest in the parts of the building which are owned by the unit owners.

Do consultees agree?

9.88 We provisionally propose that legislation should require the commonhold association to reinstate or rebuild (as appropriate) the whole of a horizontally-divided building – including the parts owned by the unit owners – in order to satisfy the indemnity principle within insurance law.

Do consultees agree?

9.89 We invite consultees’ views as to whether any other legal difficulties would arise in arranging buildings insurance for commonholds which have not been addressed by these proposals.

Consultation Question 47.

9.90 We provisionally propose that the CCS should be amended so as to require that either a copy of the buildings policy and schedule, or sufficient details of it, should be supplied to all unit owners on or before they acquire a unit, and whenever the terms of the policy change.

Do consultees agree?

9.91 We provisionally propose that the commonhold association should confirm to unit owners and their mortgage lenders that the insurance is in existence on an annual basis, and when reasonably required at other times.

Do consultees agree?

Public liability insurance

9.92 We find it difficult to understand why public liability insurance should not be readily available to commonhold associations.82 We therefore invite consultees’ views on whether it is generally available, and, if it is, whether it should be made compulsory for a commonhold association to take it out. We would expect any minimum level of compulsory cover to be set from time to time by the Secretary of State.

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82 We include in this both occupiers’ liability insurance, and property owners’ liability insurance: see paras 9.63 and 9.70 above.
Consultation Question 48.
9.93 We invite consultees’ views as to whether public liability insurance (that is, insurance against liability as an occupier and also as a property owner) is likely to be generally available for commonhold associations.

9.94 If it is generally available, we provisionally propose that details of minimum cover, permissible exclusions and excesses, and so on, should be prescribed in regulations to be made by the Secretary of State.

Do consultees agree?

Directors’ and officers’ insurance

9.95 We provisionally propose that the CCS should expressly contain a power for the commonhold association to take out a directors’ and officers’ insurance policy, if only to place the matter beyond any doubt, and to serve as a reminder to the directors of the association that it is something which they should consider. We would not suggest that it should be compulsory for a commonhold association to take out this insurance, though a local rule could require it.

Consultation Question 49.
9.96 We provisionally propose that the commonhold community statement should contain an express power for the commonhold association to take out directors’ and officers’ insurance.

Do consultees agree?

WHAT SHOULD BE THE STANDARD OF MAINTENANCE OF THE COMMON PARTS?

Introduction

9.97 The commonhold association is responsible for the repair and maintenance of the common parts. In a block of flats, or other horizontally-divided building, the common parts will include:

(1) the structure and exterior of the building,\textsuperscript{83} such as the external walls and windows, the roof, foundations, and any internal load-bearing walls;

(2) the internal common parts, such as the hallways, stairways and landings; and

(3) any exterior common parts, such as driveways, gardens, or areas of open land.

\textsuperscript{83} Commonhold Regulations 2004, reg 9.
9.98 It is likely that any car parking areas, and balconies, will also be common parts. Even if they are allocated for the sole use of an individual unit, they should be designated as "limited use" areas, rather than as part of a unit, if they are to be maintained by the commonhold association. In a commonhold comprising buildings which are detached, or divided vertically from the rest of the building, the common parts may comprise only what have been described above as the "exterior common parts".

9.99 The regulation defining the extent of a commonhold unit is not easy to follow on first reading, but, once properly construed, the thinking behind it is quite clear. If a unit is severed vertically from other units (so including all houses, whether detached, semi-detached, or terraced) then the structure and exterior may form part of the unit, or remain part of the common parts. If the unit is divided horizontally from another unit or units (such as would be the case in a block of flats), the structure and exterior must remain part of the common parts. The latter follows the practice generally adopted by modern leases of parts of horizontally-divided buildings, whether commercial or residential.

**The current law**

9.100 The 2002 Act requires that the units and the common parts be repaired and maintained, by requiring in each case that the CCS impose appropriate duties. Paragraphs 4.5.1 and 4.5.2 make provision for the repair and maintenance of the common parts and of the units respectively. Paragraph 4.5.1 reads:

the commonhold association must repair and maintain the common parts. This includes decorating them and putting them into sound condition.

9.101 As a prescribed clause it is not possible for a CCS to derogate from the paragraph. The provision ensures that, in a horizontally-divided building, where the integrity of the building is dependent upon the maintenance of the structure and the exterior, a basic standard of repair must be maintained.

9.102 Paragraph 4.5.2 then allows for the CCS to impose further duties in respect of the repair and maintenance of the commonhold units by local rules. Making these duties local rules means that they can be amended by a resolution of the commonhold association in a general meeting. An ordinary resolution would suffice, unless steps have been taken to entrench the provision.

9.103 This paragraph means that, even in horizontally-divided buildings (such as a block of flats), the CCS can take a fairly flexible approach to matters of internal repair. This approach reflects the fact that a lack of repair within a unit is generally unlikely to have repercussions outside of the unit. If there is an internal load-bearing wall within the unit, then it would constitute part of the main structure, and thus part of the common parts,

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85 CLRA 2002, s 14(2).
86 CLRA 2002, s 26(c).
87 See Glossary.
88 See ch 8, paras 8.54 to 8.67.
and so have to be repaired by the association. Other units may be affected if, for example, an owner fails to keep in repair water pipes or drainage pipes within a unit which serve only that unit, but such issues can be addressed by local rules. Even if they are not, then the law of nuisance would still apply. If a drain, pipe or wire serves more than one unit, or is situated outside the unit in question, then it must form part of the common parts. We do not therefore see the need for the CCS to make specific provision for internal repairs.

9.104 Both paragraphs 4.5.1 and 4.5.2 refer to “repair” and “maintenance”. “Repair” and “maintain” are both words which are well-known within landlord and tenant law, and are likely to be construed in a similar way when they appear in a CCS. “Repair” is generally construed as including “to put in repair” but, as the CCS is intended to be a document which is readily understood by non-lawyers, it seems sensible to make it clear that it does have this extended meaning.

Constructions of the current law

9.105 It has been suggested to us that the prescribed CCS ought to make more detailed provision for the repair of the common parts, as the general standard is not always appropriate. It is said, for example, that paragraph 4.5.1 does not make adequate provision, say, for the repair and maintenance of the common parts of a listed building which has been converted into flats. Here it may be appropriate for repair and maintenance to be to a particularly high standard.

9.106 Our view is that it is right that the CCS provides for the common parts to be kept in repair, by which we mean adequately repaired, and that paragraph 4.5.1 does provide for this. It is difficult to envisage circumstances where the CCS should allow the commonhold association to keep the common parts in anything less than an adequate standard of repair, bearing in mind that the courts can and do take into account the age and projected future life of a building in determining what an appropriate standard of repair should be.

9.107 Courts have expressed differing views on whether adding similar words to an obligation “to repair” actually adds anything to its meaning: for example whether adding words such as “amending and renew” add anything to the basic requirement to repair. It has been suggested to us that the wording of paragraph 4.5.1 might lead some lawyers to take the cautious view that it did not cover a “renewal”; that is, where some item had to be replaced rather than repaired. We do not think this interpretation could have been intended, and it might be better for the point to be clarified.

91 Proudfoot v Hart (1890) 25 QBD 42.
92 Illustrated by a case such as Plough Investments Ltd v Manchester City Council [1989] 1 Estates Gazette Law Reports 244 (Scott J).
93 Compare the views of Hoffmann J in Norwich Union v British Railways Board [1987] 2 Estates Gazette Law Reports 137, who declined to try to attribute a separate meaning to each word of a covenant which had been drafted in what he referred to as a ‘torrential’ style, with the decision in Crédit Suisse Ltd v Beegas Nominees Ltd [1994] 1 Estates Gazette Law Reports 76 (Ch) that “renew and amend” did add something to what might be inferred from a covenant merely to repair.
9.108 Our attention has also been drawn to a provision in the Climate Change (Scotland) Act 2009 (asp 12),\textsuperscript{94} which includes “the installation of insulation” in provisions relating to general powers to repair and maintain. It might be appropriate to include an equivalent provision in the prescribed part of the CCS, so making it of general application (and irremovable). Even if not included, it would of course be possible for a similar provision to be adopted by ordinary resolution as an additional local rule.

9.109 In some commonholds the basic standard of repair provided for in paragraph 4.5.1 may be insufficient: for example, a country house which is a prestigious listed building and has been converted into a number of commonhold units. The prospective purchasers may well take the view that, say, the communal hall and staircase should be kept in more than a basic standard of repair.\textsuperscript{95} Even though there is authority for the proposition that the interpretation of a repairing covenant must take into account the nature and location of a building,\textsuperscript{96} prospective purchasers may wish to have the assurance that a higher standard will be applicable in such a case. We take the view that there is nothing, as the law currently stands, to prevent the CCS, by a local rule, from imposing a higher standard of repair, if appropriate. A CCS might, for example, require a listed building which had been converted into flats to be maintained in a state of repair and decoration (both internal and external) appropriate to a listed building of architectural importance. Although it seems likely under the current law that repairing obligations could be supplemented by a local rule, it seems desirable to put this matter beyond doubt. If the commonhold association so desired this requirement could then be entrenched so as to ensure that it could not be amended by a simple majority vote.

**Proposals for reform**

9.110 We provisionally propose that:

1. the prescribed CCS should continue to require that the common parts be repaired and maintained;
2. the standard of repair should be specifically extended to cover “renewals”, that is, the replacement of items which could not be economically repaired;
3. the installation of insulation should be deemed to be a repair or renewal; and
4. as it is possible for repairing obligations under the prescribed part of the CCS to be supplemented by a local rule, it should be made explicit that local rules made under the CCS may prescribe a higher standard of repair, if this is thought appropriate;
5. with horizontally divided buildings, matters relating to the internal repair of units should be left to local rules; and
6. with detached, or vertically divided buildings, all matters relating to repairs should be left to local rules.

\textsuperscript{94} S 69, inserting the wording in rule 1.5 in sch 1 (Tenements Management Scheme) to the Tenements (Scotland) Act 2004 (asp 11).

\textsuperscript{95} “Repair” includes decoration: Commonhold Regulations 2004, sch 3, para 4.5.1.

\textsuperscript{96} There is, for example, a reference in *Gibson Investments Ltd v Chesterton plc* [2002] EWHC 19, [2003] 1 Estates Gazette Law Reports 142 (Neuberger J) to the building having to be "in a state of repair which is appropriate for a high class office building in a prime office location in Birmingham."
Consultation Question 50.

9.111 We provisionally propose that the provisions in the prescribed commonhold community statement requiring the repair of the common parts should be extended to require also “renewals”; that is, the replacement of “like with like” if something should be beyond economic repair.

Do consultees agree?

9.112 We provisionally propose that the installation of adequate thermal insulation should be deemed to be a repair.

Do consultees agree?

9.113 We provisionally propose that it should be possible for the repairing obligations required by the CCS to be supplemented by a local rule requiring a higher standard of repair, if appropriate.

Do consultees agree?

9.114 We provisionally propose that, with horizontally-divided buildings (so including all flats), matters relating to the internal repair of units should be left to local rules.

Do consultees agree?

9.115 We provisionally propose that with vertically-divided buildings (that is, all houses, whether detached, semi-detached or terraced) all matters relating to repair (whether internal or external) of the units should be left to local rules.

Do consultees agree?

RIGHTS OF ENTRY

Introduction

9.116 The starting point under the law in England and Wales is that a person who enters land belonging to another without permission is a trespasser. The owner can require them to leave, and trespass can generally be restrained by a court injunction if necessary. Anyone who does enter on land which belongs to another will need to be able to point to some right which permits them to do so. For example, the person may be able to point to a right of way that is being exercised across a piece of land which does not belong to them.

9.117 When houses are built on adjoining plots of land, it is not generally necessary or usual for someone to have a right to enter their neighbour’s building. It is, however, fairly common to provide that someone has the right to go on to someone else’s land in order to repair or maintain a building on their own land. Indeed, the lack of such a right in

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97 In its extended meaning in land law, “land” will also include any building erected on it.
many house deeds was considered a sufficiently serious matter for Parliament to pass
the Access to Neighbouring Land Act 1992. This Act permits someone who needs to
go on to a neighbour’s land to maintain a building on their own land to obtain a court
order to permit it. The court is able to impose appropriate conditions on the person
seeking access. We understand that terms as to working hours, and that contractors
should have appropriate insurance, are commonly imposed in practice.

9.118 Within blocks of flats, the need to obtain access is generally considerably more
important. For example, access to a flat may be necessary to carry out repairs to the
exterior of a block. It may also occasionally be necessary that an individual flat owner
should have access to a neighbouring flat in order to repair their own. The mere fact
that flats can have neighbours above and below, as well as on either side, increases
the chances that access may be needed.

The current law

9.119 The general law with respect to freehold properties is as set out in paragraph 9.117
above. Within blocks of leasehold flats it is usual for a lease to reserve extensive rights
of entry,\(^{98}\) usually for both the landlord and/or management company, and for
neighbouring leaseholders. It is usual for the lease to provide that these rights of access
are only to be exercised on the giving of reasonable notice and at certain times of the
day, with exceptions being made in case of emergency.

9.120 The 2002 Act, and the Commonhold Regulations, do not make express provision for
rights of entry for access. The scheme of the CCS assumes that “rights for commonhold
units” and “rights over commonhold units” will be dealt with by appropriate local rules.\(^{99}\)
This assumption has been made as the extent of these rights will depend entirely on
the physical layout of the commonhold. Any attempt to standardise them might cause
as many difficulties as it would solve.

9.121 Government guidance on the drafting of a CCS\(^{100}\) includes specimen wording for the
local rules that may typically be required. As well as including suggested wording setting
out unit owners’ rights to use the common parts,\(^{101}\) the Guidance also includes
specimen wording for rights over commonhold units, including rights of entry both for
the commonhold association, and for other unit owners.\(^{102}\)

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\(^{98}\) It should carefully be noted that we are referring here to “rights of entry” for access, and not the “right of re-
entry”, which is the basis of the law of forfeiture.


\(^{100}\) Commonhold: Guidance on the drafting of a Commonhold Community Statement including Specimen Local
Rules (Department for Constitutional Affairs, December 2004).

\(^{101}\) Commonhold: Guidance on the drafting of a Commonhold Community Statement including Specimen Local
Rules (Department for Constitutional Affairs, December 2004) paras 47 and 48, with suggested wordings for
para 6 of Annex 2.

\(^{102}\) Commonhold: Guidance on the drafting of a Commonhold Community Statement including Specimen Local
Rules (Department for Constitutional Affairs, December 2004) para 51, with suggested wordings for para 7
of Annex 2.
Criticisms of the current law

9.122 In general, it seems correct to rely upon custom-drafted local rules to deal with the rights that will generally be required to ensure that unit owners can make full use of their units, and the facilities of the commonhold. Nevertheless, a case could be made for saying that some rights of entry will be required in all commonholds, and that some express provision could therefore be made in the prescribed CCS. Including rights of entry would ensure that the point was not overlooked, and provide a measure of standardisation. The CCS of an individual commonhold could then either rely on the prescribed rules, or make more detailed provision.

9.123 Having a broadly-worded right of entry could lead to the right being more far-reaching than was intended. For example, the commonhold association could be given a right of entry for any purpose "if required to ensure that full effect should be given to the rights and duties set out in the CCS". Such an extensive right might, however, be construed as allowing the association to check that the interior of the unit was being kept in repair, and that any restriction on use was being observed. Rights of entry of that kind might be viewed as too intrusive, and inconsistent with the principle that commonhold should facilitate the freehold ownership of flats.

9.124 There is also the possibility that a commonhold can, and often will, include houses as well as flats. The rights of entry that are thought appropriate to houses may be less extensive than those which are appropriate to flats. It would seem unlikely that a "one size fits all" approach will offer a fair solution. Broadly speaking, it seems that horizontally-divided buildings are likely to need to be subject to more extensive rights of entry.

9.125 The prescribed CCS does not currently attempt to address rights of entry at all. It would seem desirable that some standardised provision should be made for flats, but that what is appropriate for a flat may well be inappropriate for a house.

Proposals for reform

9.126 We think it would be useful to prescribe two levels of rights of entry:

(1) a basic level of rights of entry which would be applicable to all units. These can probably be pitched at a low level, for example, if access is necessary in order to repair or maintain a neighbouring building; to ensure compliance with fire or other safety regulations, if (but only if) the commonhold association is responsible for them; or for the purpose of periodic insurance valuations, if the insurance of the building is the responsibility of the association; and

(2) a more enhanced right of entry which would apply only where a building was horizontally-divided. This would clearly have to include a right of entry if a supply pipe or drain in one unit was leaking and this was affecting a neighbouring unit (which would generally be a unit below it).

9.127 In both cases the right would be exercisable subject to a specified period of notice having been given, with an exception for cases of emergency. These prescribed rights could be enhanced by local rules if more extensive rights of entry were considered desirable: for example, because of the physical features of the commonhold.
Consultation Question 51.
9.128 We invite consultees’ views as to whether rights of entry are best left to local rules, or whether rights of entry should be prescribed.

9.129 If rights of entry are prescribed, we invite consultees’ views as to whether it is necessary to make a distinction between different types of buildings.

9.130 If it is necessary to distinguish between different types of building, we invite consultees’ views as to:

(1) whether the distinction should be between those that are horizontally-divided, and those that are vertically-divided; and

(2) if some other distinction is more appropriate, what that should be.

9.131 We invite consultees’ views as to what, in each case, the appropriate rights of entry would be.

CONSENT TO ALTERATIONS

Introduction
9.132 Owners of commonhold units will inevitably wish to make changes to those units from time to time. Broadly speaking, owners of freehold houses will be able to make whatever alterations they wish, provided that they do not trespass on their neighbours’ property, create a nuisance (for example, by constructing a flue which interferes with a neighbour’s enjoyment of his or her own property) or deprive their neighbour of any right to have his or her building supported. Issues of support are of particular importance within horizontally-divided properties.

The current law
9.133 The CCS forbids any alterations being made to the common parts without the support of an ordinary resolution of the commonhold association, but is silent as to the making of alterations within an individual unit. These are matters which have been left to local rules.

9.134 In many cases it will be appropriate for local rules to be made. The specimen clause suggested by Government guidance on the drafting of a CCS is as follows:103

A unit owner or tenant must obtain the written consent of the commonhold association before –
(a) making any alteration to a commonhold unit which affects the common parts;
(b) altering or adapting the electrical or water supply to a commonhold unit or wiring or plumbing within the unit.

103 Commonhold: Guidance on the drafting of a Commonhold Community Statement including Specimen Local Rules (Department for Constitutional Affairs, December 2004), paras 88 and 89.
9.135 This provision would seem to have been drafted on the assumption that the consent would be given by the directors of the commonhold association, rather than that the matter would have to go a vote of the membership of the association. In relation to alterations which affect the common parts, however, this assumption appears contrary to the clear meaning of paragraph 4.6.1 of the CCS, which requires that alterations to the common parts have the approval of an ordinary resolution of members. This requirement may be appropriate if some substantial change (for example, to the layout of the grounds) is proposed, but it appears to cover any alteration to the common parts, no matter how trivial.

**Criticisms of the current law**

9.136 It has been drawn to our attention that what are essentially alterations to an individual unit may technically amount to a trespass to the common parts. For example, installing a new boiler, or the duct for a ventilation fan, may require that an opening be made in the exterior wall of a unit, which forms part of the common parts. It is not clear whether, in the words of the Government guidance quoted above, “affects” the common parts covers a direct, (though minor,) trespass to the common parts, or whether it has a more restricted meaning.

9.137 We think that it should not always be necessary for any alteration to the common parts to be authorised by an ordinary resolution. An alteration to an individual unit which incidentally requires a minor alteration to the common parts – for example, an alteration such as those set out above – should not necessarily require the consent of an ordinary resolution. In most cases it ought to be possible to delegate the giving of such a consent to the directors. In many cases it may seem unduly onerous to require any consent to such a minor alteration at all. In a property of conventional brick-built construction the making of an opening in an exterior wall for a boiler flue or ventilation outlet may be a minor matter. However, we think that some requirement for consent should be retained. With some forms of construction this may have implications for the integrity of the structure, or its fire safety. There is also the possibility that relocating the outlet for a boiler flue may adversely affect the comfort of neighbours in adjacent properties, if they have a window or balcony in the immediate vicinity.

**Proposals for reform**

9.138 Whilst paragraph 4.6.1 of the CCS would seem to be appropriate if a substantial change to the common parts is proposed, it seems unduly onerous to require that consent be given by ordinary resolution if it is a minor alteration to the common parts which is incidental to a change within a unit which is being made by a unit owner. We therefore provisionally propose that paragraph 4.6.1 of the CCS be amended so as to enable local rules to determine whether such minor alterations to the common parts should be permitted generally, or with the permission of the directors.
Consultation Question 52.

9.139 We provisionally propose that the commonhold community statement should be amended to provide that alterations to the common parts which are incidental to internal alterations made by a unit owner to his or her own unit should not require the consent of the members by an ordinary resolution.

Do consultees agree?

9.140 We provisionally propose that the giving of consent to such proposals should be delegated to the directors.

Do consultees agree?

9.141 We invite consultees' views as to whether:

(1) “minor alterations to the common parts” should be defined as we have outlined at paragraph 9.137 above; or

(2) some other criterion could be adopted to distinguish minor alterations from those which should continue to require the consent of an ordinary resolution by the members.

COMMONHOLDS AND LONG-TERM CONTRACTS

Introduction

9.142 Most commonholds look to a variety of suppliers for the provision of a range of services. Some commonholds may choose directly to employ persons such as cleaners and gardeners, but most will probably enter into a contract with a company which offers to provide such services, either daily, or at appropriate intervals. The actual cleaners or gardeners would then be employed by that company. The range of possible contractors whom the commonhold may wish to retain is wide: larger commonholds may wish to enter into standing arrangements with companies who can offer plumbing, electrical and general maintenance services.

9.143 Many commonholds will also wish to enter into contracts for services which are not dependent upon an employee of the provider attending on a daily or weekly basis, but where a technician may be required to attend from time to time to check, and service the installation. TV, telephone and broadband services may fall into this category, as may entryphones, security alarms, and lift installations. These are examples of services for which commonhold associations may currently contract: with the speed of technological development, it is impossible to predict what services may be required in the future.

9.144 We are also aware of developers entering into long-term contracts for the supply of utilities such as electricity, gas or hot water to a development.¹⁰⁴

¹⁰⁴ 25-year contracts for the supply of electricity and hot water were the subject matter of the dispute in BDW Trading Ltd v South Anglia Housing Ltd [2013] EWHC 2169 (Ch), [2014] 1 WLR 920.
The current law

9.145 The current position is that commonhold associations are free to enter into such contracts as they see fit. No maximum duration is specified, and terms are generally a matter for negotiation, subject only to provisions of general applicability such as the Unfair Contract Terms Act 1977. A commonhold association will not be an “individual”, so much of the protection extended to “consumers”, under provisions such as the Consumer Rights Act 2015, will not apply to commonhold associations, who may be classed for many purposes as business organisations.

Criticisms of the current law

9.146 In our Call for Evidence, consultees from one commonhold complained that, before they purchased their units, the developer had entered into a management contract relating to the building which was “disadvantageous”. The managers have since been replaced. Commonhold would appear to be particularly susceptible to the unit owners finding that they are already committed to disadvantageous or otherwise unattractive contracts, as the commonhold association is brought into existence before the commonhold can be set up. When the association is first in existence, it will be entirely controlled by the developer. Although the ownership of the association will change when it comes under the control of the unit owners, it will be considered to be a single legal entity with a continuous existence.

9.147 In leasehold, there is a similar problem, but certain safeguards which have been put in place to protect leaseholders may help them. If developers were to enter into a highly unfavourable contract then they – or a successor landlord – would run the risk of finding that leaseholders sought a ruling under section 19 of the Landlord and Tenant Act 1985 that the costs had not been reasonably incurred. They also run the risk, in many instances, that the leaseholders will exercise the right to manage (RTM). If they do so, then they will be able to assume control of the management functions. These are broadly defined, and are likely to include the service which is covered by the contract which they allege is disadvantageous.

9.148 The 2002 Act is silent as to what happens to existing contracts when an RTM company assumes management functions. It was left unclear when the Bill was being debated in Parliament. We understand that it is still unclear what the legal position actually is, but the existence of the RTM may well discourage developers and suppliers from entering into long-term contracts which the leaseholders may consider disadvantageous.

9.149 We are aware of anecdotal evidence that long-term contracts can raise particularly difficult problems where they involve the hire of equipment which remains the property of the supplier (for example, entryphone systems, including the associated wiring). The providers also reserve the right to remove it. The providers may not object to the cancellation of the contract, but will then remove their equipment, and it is very difficult to fit any replacement equipment and wiring after the building has been constructed.

105 This allows leaseholders to challenge charges made as part of a service charge if they have not been reasonably incurred.

106 CLRA 2002, ss 71 to 113.
9.150 We take the view that there is a danger that commonhold will offer scope for the perpetuation of abuses which have sometimes been encountered in leasehold. Indeed, as currently enacted, the commonhold legislation does not contain the same safeguards.¹⁰⁷

Proposals for reform

9.151 A possible solution would be to give commonhold associations the option of determining a long-term contract, without penalty, within a set period of, say, six months from the date where the association came fully under the effective control of its members. A long-term contract for these purposes would be any contract which would endure for more than 12 months after the relevant date. We do not think it necessary to give the supplier a corresponding option to determine the contract, as it would have entered the contract in the full knowledge that it was entering into a legal relationship with a body which would, in the foreseeable future, be controlled by the unit owners.

Consultation Question 53.

9.152 We invite consultees’ views as to whether existing long-term contracts have been a problem which leaseholders have encountered.

9.153 If they have, then we further invite leaseholders to let us have examples.

Consultation Question 54.

9.154 We provisionally propose that commonhold associations should be given the right, within a set period from the date when the unit owners take effective control of the commonhold association, to cancel contracts which were entered into by the association before that date. (It would be necessary to define these terms so as to exclude the scenario where the units were “sold” to associates of the developer).

Do consultees agree?

9.155 We provisionally propose that a “long-term contract” should be defined as a contract which must run for more than 12 months.

Do consultees agree? If not, what longer or shorter period would be appropriate?

9.156 We provisionally propose that a commonhold association should have to exercise this right within six months from the commonhold coming under the effective control of the unit owners (being actual “arms-length” purchasers of the units).

Do consultees agree? If not, what longer or shorter period would be appropriate?

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¹⁰⁷ It is not suggested that these safeguards are always effective: see n 106.
Consultation Question 55.

9.157 We invite consultees’ views as to the difficulties that can arise when the long-term contract includes the hire of equipment which remains the property of the contractor and which they have reserved the right to remove if the contract should be terminated. We would appreciate any examples of contracts involving the hire of equipment, or of long-term contracts generally, that consultees are able to provide.
Chapter 10: Financing the commonhold

INTRODUCTION

10.1 A key task of the commonhold association is to set and collect contributions to cover the common expenses. The 2002 Act refers to these as the "commonhold assessment".¹ In this Consultation Paper they are referred to as "contributions to shared costs". In all commonholds which include a horizontally-divided building, such as a block of flats, these will include repairs to the exterior, main structure and roof.² The contributions will also have to cover the cost of insurance.³ In most commonholds there will also be the cost of maintaining the grounds of the building, including any drives, car parking areas, and garden areas. In some more elaborate commonholds there will also be the cost of providing additional facilities such as reception or porters' services, any on-site offices which serve the commonhold, any leisure facilities, and sometimes accommodation for staff. Commonholds intended for those who have retired may include the provision of a resident manager and – as well as the facilities already mentioned – communal lounges, a launderette and guest rooms. Essentially, the contributions to shared costs will include all the heads of expenditure which in leasehold may form part of the service charge.

10.2 Service charges have long been a source of controversy in leasehold. Landlords incur expenditure on expenses such as repairs and insurance, and the management of the building, then pass on the cost to the leaseholders. They can pass on only those items of expenditure which are covered by the lease. Sometimes leases include a broadly worded clause to allow landlords to pass on to any costs which benefit the leaseholders.

10.3 Parliament has then intervened to protect leaseholders in two main respects.

(1) Before incurring expenditure of over a designated amount on "qualifying works", or entering into certain long-term contracts, the landlord is required to consult with leaseholders.⁴

(2) Additionally, a landlord may recover expenditure through the service charge only to the extent that it has been "reasonably incurred" and if the works or services have been provided to a "reasonable standard". Landlords may therefore incur expenditure, and find that they are unable to recover, through the service charge, all of what they have spent.

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¹ CLRA 2002, s 38. See Glossary.
² This will be because of the combined effect of the Commonhold Regulations 2004, reg 9 and sch 3, para 4.5.1. Horizontal division and its implications are discussed further in ch 9, para 9.73 onwards.
³ Commonhold Regulations 2004, reg 9 and sch 3, para 4.4.1. We discuss insurance further in ch 9 para 9.60 onwards.
⁴ Under the Landlord and Tenant Act 1985, s 20, a landlord must consult on (broadly) repair and maintenance works which would result in any leaseholder having to pay more than £250, or contracts which extend over a period of more than a year and require any leaseholder to pay more than £100 per year.
10.4 Applications relating to the consultation requirements and the reasonableness requirement are generally made in England to the First-tier Tribunal (Property Chamber) or, in Wales, to the Residential Property Tribunal (Wales) (“the Tribunal”), with appeals going to the Upper Tribunal (Lands Chamber). In exceptional cases the issues may be determined by a court.\(^5\)

10.5 Through these measures leaseholders have a substantial measure of protection against excessive service charges. They cannot be liable for costs which have not been provided for in the service charge provisions of their leases. Costs must also have been reasonably incurred. There are, however, gaps in the law, and service charges remain one of the most common areas of dispute between landlords and leaseholders.

10.6 It should be noted that the provisions to protect leaseholders were enacted on the assumption that the landlord would be an external landlord: the original developer who had retained the freehold reversion, or an investor to whom the freehold had been sold on. Nevertheless, the provisions apply with equal force where the landlord is a freehold management company (“FMC”) (a company comprised of the leaseholders which has acquired the freehold), or where the service charge is set and levied by a residents’ management company (“RMC”) or a right to manage company (“RTMCos”).\(^6\) If a leaseholder makes an application alleging a failure to consult, or that service charges have not been “reasonably incurred”, then the application may have the result that any of these leaseholder-controlled companies find themselves facing a shortfall. It is often not clear how this shortfall can be made up. We are keen to avoid the possibility of a similar difficulty arising within commonhold.

10.7 The owner of any building has to budget for its future maintenance. Some expenditure will be incurred every year. Much of the cost of maintenance, however, though cyclical, may not arise every year: for example, the cost of painting the exterior, or replacing a flat roof. There will, with most blocks of flats, be examples where costs will not be incurred every year but, when they do arise, they will be substantial. Exterior decoration may require the erection of expensive scaffolding. A flat roof may need to be replaced. A lift may require eventual replacement, in, say 40 or 50 years’ time.

10.8 The position with flats is, however, rather different from the position with a freehold house. The owner of an individual property may decide that he or she cannot afford to replace some item, or even to carry out essential repairs, and simply not do so. With shared facilities, on the other hand, this is not generally an option. The other owners will claim, with some justification, that they purchased their property on the basis that repairs would be carried out, and facilities would be renewed, and their expectations should be met.\(^7\)

10.9 Conveyancers who draft leases of flats deal with the problem of budgeting for substantial future expenditure by including a provision in the lease which allows the

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\(^5\) Only the Tribunal and not the court has power to dispense with the consultation requirements of the Landlord and Tenant Act 1985, s 20: see s 20(1)(b).

\(^6\) We note in para 5.1 of Appendix 5 and in the Glossary the distinctions we draw between FMCs, RMCs and RTMCos.

\(^7\) The same principle applies whether they are relying on a lease or the content of a CCS.
landlord to build up a reserve fund. Ideally the contribution to the reserve fund will be worked out by estimating the likely future cost of a project such as decorating the exterior, and dividing it by the number of years before the work will be needed. This calculation will have to be done for each item which the reserve is intended to cover: for example, exterior decoration, and the eventual cost of replacing a lift. Separate reserve funds may be maintained, or a single reserve fund may be intended to cover more than one item.

10.10 The effect of having a reserve fund or funds is therefore to “smooth” expenditure, so that – although the service charges will tend to rise each year with inflation – there should not be a marked increase in the year when substantial expenditure is incurred, unless the likely expenditure has been under-estimated.

10.11 This chapter will therefore cover:

1. the contribution to shared costs: the way in which the regular financial commitments of the commonhold are met;

2. the contributions to the reserve funds, which make provision for the expenses of the commonhold which it can be foreseen will arise in the future, but which will not recur every year;

3. the share of the commonhold contributions to be paid by each owner – how the expenses are divided among the unit owners – and how they may be varied; and

4. the issues which arise as to who should be liable to meet a unit’s share of the commonhold expenses when a unit is transferred.

10.12 We also touch on the emergency contribution to shared costs: where the commonhold association need to raise funds urgently to meet some emergency. This will be examined more closely in Chapter 11 in the context of some broader issues.

10.13 In the interests of clarity, we shall look at these issues in turn, setting out what the current law is, then considering the issues with the current law, and finally making our proposals for reform.

Contributions to shared costs and to reserve fund(s): an overview

10.14 Whilst the law on leasehold service charges is designed to protect leaseholders from landlords abusing their position, commonhold begins with an entirely different starting point. The contributions to shared costs are set and collected by the commonhold association, and all unit owners within the commonhold are members of the association. It is therefore assumed that there is a correspondence of interests between those who set the contributions, and those who have to pay them.

10.15 The 2002 Act gives the directors of a commonhold association a general power to manage the commonhold in accordance with the commonhold community statement

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8 It should be noted that a landlord may build up a reserve fund only if the terms of the lease entitle him or her to do so.
The CCS must then make provision for the directors to raise the income required to meet the expenses of the commonhold.\(^9\) The 2002 Act in effect provides for the commonhold association to obtain its funding from the members in three different ways:

1. the commonhold assessment, which is intended to cover the regular annual expenditure of the association, and which has been budgeted for.\(^11\) We refer to this as the “contribution to shared costs”;

2. an emergency assessment, which may be raised to meet urgent expenditure which is unforeseen.\(^12\) We refer to this as “an emergency contribution to shared costs”; and

3. the reserve fund levy, which is a periodic additional charge to meet costs which are likely to arise, but not in the forthcoming year, and for which provision should therefore be made.\(^13\) We refer to this as “the contribution to the reserve fund” (or funds).

10.16 In this chapter we consider points (1) and (3). We consider point (2) separately in Chapter 11. We also consider in this chapter the issues which arise as to who should be liable to meet a unit’s share of the commonhold expenses when a unit is transferred.

**CONTRIBUTIONS TO SHARED COSTS**

**The current law**

10.17 The CCS requires the directors to make an annual estimate of the income needed that year, which must be raised from the unit owners.\(^14\) The following process must then be followed:

1. the directors must give notice of this estimate to the unit owners, using a prescribed form;\(^15\)

2. the unit owners then have the right to make written representations to the commonhold association within one month;\(^16\)

3. the directors have a duty to consider any representations made;\(^17\) and

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\(^9\) CLRA 2002, s 35.
\(^10\) CLRA 2002, s 38.
\(^11\) CLRA 2002, s 38.
\(^12\) CLRA 2002, s 38, and Commonhold Regulations 2004, sch 3 para 4.2.5.
\(^13\) CLRA 2002, s 39.
\(^14\) Commonhold Regulations 2004, sch 3 para 4.2.1.
\(^15\) Commonhold Regulations 2004, sch 3 para 4.2.2.
\(^16\) Commonhold Regulations 2004, sch 3 para 4.2.3.
\(^17\) Commonhold Regulations 2004, sch 3 para 4.2.4.
the directors must then give a further notice, again using a prescribed form, to each unit owner specifying the payments required and the date on which each payment is due. The date specified for the payment of the first instalment must be not less than 14 days after the giving of this notice.

10.18 The CCS imposes a duty on unit owners to make the contributions to shared costs required by the directors. 

10.19 A noteworthy feature of the current legislation is that, although the directors are required to consult with the unit owners on the level of contributions required to maintain the commonhold, the decision is ultimately one for the directors alone. 

**Criticisms of the current law**

Should contributions to shared costs need prior approval of the members?

10.20 Several respondents to our Call for Evidence suggested that the provisions relating to commonhold contributions set out in the 2002 Act and the CCS should be amended so as to require the owners generally to approve the level at which they were set. Others suggested that some of the protections given to those paying leasehold service charges should be extended to unit owners in a commonhold. 

10.21 Under the current law there is no provision for unit owners to challenge contributions to shared costs on the basis that they are not reasonable. We do not think it would be appropriate to import into commonhold measures of protection which are intended for the very different situation where service charges are set by a landlord. In particular, if unit owners can challenge the level of contributions after they have been set, commonhold associations run the risk of facing a shortfall in their budget.

10.22 Requiring the unit owners to approve the commonhold contributions before they are finally set, however, does have the advantages set out below:

1. It increases owners’ active engagement with the running of the commonhold;

2. There may be fewer problems with late or non-payment if unit owners have had an opportunity to approve what has been set, and are aware that the contributions have been approved by their fellow residents; and

3. Directors will not feel that they bear the sole responsibility for ensuring that the commonhold is run on a sound financial footing.

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18 Commonhold Regulations 2004, sch 3 para 4.2.4.

19 Commonhold Regulations 2004, sch 3 para 4.2.15.

20 As with any decision of the directors, the unit owners as members of the company may override their decision only if they pass a special resolution in accordance with Art 52 of the articles of association. This is discussed further in ch 9 at paras 9.12 and 9.16.

21 Including Mr Peter Smith (retired academic) and Mr Graham Paddock (South African author on sectional titles).

22 Including Field Fisher (solicitors) and the Yorkshire Building Society (mortgage lender).
10.23 The disadvantages of having the owners approve the level of contributions are largely practical. We have identified those set out below.

(1) There is a danger that unit owners will insist upon contributions being set at a level which is unrealistically low. But if they do this, they will have to bear the consequences.

(2) The normal situation in companies is that the directors take responsibility for the management of the organisation, though one can argue that commonhold associations are a special case.

(3) A likely consequence of requiring the unit owners to approve the contributions will be that each commonhold association will have to hold two general meetings each financial year. Traditionally the accounts of a company for the previous year are laid before the annual general meeting. The “laying of accounts” is no longer formally required by the Companies Act 2006, but it is good practice. It is also good practice for the general meeting to consider the accounts (for year one) as soon as possible after the financial year has ended. But following that practice would mean that it would be far too early to consider setting the contributions for the following financial year (year three – it would have been necessary to set the contributions for the current financial year – year two – before the start of the financial year).

(4) Provision would have to be made for what should happen if the unit owners rejected the level of contributions proposed by the directors. The law could, for example, provide that, if the proposed level of contributions was rejected, then they would continue at the rate set for the previous year.23

(5) Directors may be unwilling to continue to serve if they find that their recommendations are rejected by the unit owners.

10.24 It would be possible to dispense with the need to hold a second general meeting each year to approve the level of contributions by making use of the written resolution procedure. This procedure enables a resolution to be passed without the need for it to be proposed and voted on at a meeting. It has become more generally available since the passing of the Companies Act 2006. The text of the resolution is circulated to all unit owners, and it is passed by the requisite majority either signing and returning a single copy, or each signing their own copy, or by any combination of the two.24 It is possible to provide for this to be done electronically. If approval of the level of contributions is likely to be a mere formality, then using the written resolution procedure could avoid the need for an unnecessary meeting. If the level of contributions is likely to be controversial, then it may be desirable for a meeting to be convened so that matters can be fully discussed. This would be possible under company law, as it generally applies.

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23 This presupposes that the proposed level of contributions is rejected because unit owners are objecting to an increase. This will not always be the case, but it is generally likely to be the situation.

24 In the case of an ordinary resolution, this would need more than 50% of the available votes. In the case of a special resolution, it would need 75% or more of the available votes.
10.25 As the 2002 Act is currently drafted, the contribution to shared costs is treated as an entirely different entity from the contribution to the reserve fund, although the CCS makes some provisions which are common to both. If it should be decided that the setting of the contributions to shared costs should require the approval of the membership, the same considerations would seem also to apply to the setting of the contribution to the reserve fund. If reserve fund contributions are to remain as separate from the contribution to shared costs it would seem desirable that consultation on, and approval of both should take place simultaneously.

Should the minority be given any protection against unexpected expenditure?

10.26 A commonhold association is given a general power to manage the commonhold in accordance with the CCS. This general power gives a greater degree of flexibility than would apply within leasehold, but there is a concern that it may lead to a majority of unit owners wanting a much higher standard of facilities than was envisaged when the commonhold was first set up, or when some of the existing owners acquired their units. For example, the majority may agree with the directors that the internal common parts of a commonhold should be decorated and maintained to a more luxurious standard than had previously been the case.

10.27 Under the current law “alterations” (that is, physical changes) to the common parts already need the approval of the members by an ordinary resolution. However, the redecoration and refurbishment of the common parts to a much higher standard than before would not generally amount to such an “alteration”. Neither would the provision of services to a much higher standard. If it had been usual to provide concierge services during weekday office hours, it would be considerably more expensive to provide a 24-hour a day service, seven days per week.

10.28 Requiring the directors to obtain prior approval of the proposed annual contribution to shared costs should ensure that any such substantial changes are made only with the approval of a majority of unit owners. But the minority may still feel that they are being required to contribute towards a level of expenditure to which they did not originally sign up.

10.29 A buyer who favoured having some kind of safeguard might argue that he or she had bought a unit in the commonhold in the expectation that its environment and services would remain broadly the same as when he or she purchased. The contrary argument is that commonhold is intended to be democratic, and that the wishes of the majority should normally prevail.

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25 The contribution to shared expenditure is dealt with by CLRA 2002, s 38 and Commonhold Regulations 2004, sch 3, paras 4.2.1 to 4.2.5. The reserve fund contribution is addressed by CLRA 2002, s 39; Commonhold Regulations 2004, sch 3, paras 4.2.6 to 4.2.14. The provisions applying to both are Commonhold Regulations 2004, sch 3, paras 4.2.15 to 4.2.17. The provisions for diversion of rent from a tenant (4.2.18 to 4.2.42) also apply to both.

26 Commonhold Amendment Regulations, sch, art 52, discussed in ch 9 at para 9.12.

27 Commonhold Regulations 2004, sch 3, para 4.6.1. An ordinary resolution requires either over 50% of the votes cast to be cast in favour if the vote is taken at a meeting, or over 50% of all votes in the commonhold to be cast in favour if the written resolution procedure is used.
10.30 Our starting position is that any challenge to expenditure should be made *before* the expenditure is incurred, and not *afterwards*. We are keen to avoid within commonhold the situation which can arise where a leaseholder-controlled company is managing a building, and expenditure on the service charge is challenged after it has been incurred. If the expenditure is successfully challenged before the Tribunal, then it may be unclear how the expenditure is ultimately going to be borne.\(^{28}\) The existing requirements as to consultation on commonhold contributions go some way to giving unit owners an opportunity to object to proposed expenditure, but in addition we think that members should have to approve the estimated expenditure for the forthcoming year. Taken together, these requirements should give members who have concerns about an excessive level of expenditure ample time to raise them before expenses are incurred.

10.31 Differences of opinion over the standard of services to be provided may be an increasing problem if commonhold is to be applied to mixed tenure developments. We mean by this the situation where a single commonhold includes both units sold to private individuals, and also units owned by registered providers of social housing.\(^{29}\) The social landlords may either be renting units to social tenants, or selling units on long leases to shared ownership leaseholders, or a combination of both.\(^{30}\) The units owned by the social landlords may well constitute the minority. If the private owners who were in the majority embarked on an expensive upgrade of the building, then the social landlords or shared ownership leaseholders would find that their contributions to shared costs were higher than they had expected.

**Proposals for reform**

Should the contributions to shared costs need prior approval of the members?

10.32 We provisionally propose that there should continue to be a period of consultation on the contribution to shared costs, as provided for in the 2002 Act. After considering the advantages and disadvantages outlined at paragraphs 10.22 and 10.23 above, we consider that an appropriate balance needs to be struck. We provisionally propose that, after the consultation period, the directors should obtain the approval of the unit owners to the proposed budget and contributions for the following year in the form of an ordinary resolution in support. Generally, this resolution would be proposed and passed at a general meeting, but it would also be possible to secure approval by the written resolution procedure.\(^{31}\)

10.33 If the proposed budget and contributions failed to be approved by an ordinary resolution then payments would continue at the same level as in the preceding year. It is accepted that this is a “rough and ready” solution, and may not always be the most appropriate

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\(^{28}\) The same point applies whether the challenge is made under the Landlord and Tenant Act 1985, s 27A, because it relates to the terms of the lease; under s.19, because it relates to whether it is reasonably incurred; or under s.20, because a failure to consult is alleged.

\(^{29}\) By “registered provider of social housing” we mean, in England, those providers which are regulated under the Housing and Regeneration Act 2008. The equivalent term in Wales is “registered social landlord”.

\(^{30}\) A “long lease” is a lease that is granted for a term of more than 21 years. A shared ownership lease is a lease under which the leaseholder purchases an equity “share” of a house or flat (usually between 25 and 75%) and pays rent on the remainder of the property. The lease permits the leaseholder to acquire additional shares in the property over time, usually up to 100%.

\(^{31}\) See Glossary.
one, but it will ensure that there is an opportunity for reconsideration if – as seems more likely – the unit owners are objecting to a proposed increase. It should also ensure that the commonhold association is not left without any means of raising at least the greater part of the income that it needs.

10.34 We also provisionally propose that the same procedure would apply to a proposal to require contributions to the reserve fund or funds. If the proposals for the forthcoming year were not approved, then the reserve fund contributions would also continue at the same rate as in the preceding year. We would normally expect that the directors would put the contributions (both for the shared costs and the reserve fund or funds) before the unit owners for consultation at the same time. They would then require approval by separate votes, but normally held at the same time.

**Consultation Question 56.**

10.35 We provisionally propose that the proposed contributions to shared costs should require the approval of the members of the commonhold association. This approval would generally be given by a resolution passed in a general meeting, though it could be passed by the written procedure.

Do consultees agree?

10.36 We provisionally propose that this approval should be given by an ordinary resolution (over 50% majority), rather than by a special resolution (at least 75% majority).

Do consultees agree?

10.37 We invite consultees’ views as to the suggestion that if the proposed level of contributions failed to secure approval, the level of contributions required in the previous financial year should continue to apply.

10.38 We invite consultees’ alternative proposals to address the issue of what should happen if the directors’ proposed level of commonhold contributions fail to obtain approval.

Should the minority be given any protection against unexpected expenditure?

10.39 We take the view that in general the principle should be that the wishes of the majority of the unit owners should prevail when deciding the standard of repair and decoration of the building, the level of maintenance of the garden, and similar matters, which should apply within the commonhold. This approach should be subject to the principle that it should not be possible to derogate from the minimum standard of repair set out in the CCS. If the majority wish to make changes, then these will generally be reflected in the estimates of expenditure put forward for consultation, and the support of the majority would then be needed. Occasionally it may be appropriate for a change to be reflected

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32 Commonhold Regulations 2004, sch 3 para 4.5.1. We discuss in ch 9 at paras 9.105 to 9.110 the possibility that it may sometimes be appropriate to specify a higher standard in the CCS by a local rule.
by the amendment, or introduction, of a local rule. 33 Again, this will require the support of an ordinary resolution. An ordinary resolution will also be required to make alterations to the common parts. 34

10.40 In general, therefore, those who are purchasing a unit in a commonhold will do so on the understanding that the wishes of the majority are likely to prevail. We feel that it is more likely that unit owners will want to keep all commonhold contributions at a moderate level rather than embark on "gold-plating" facilities or services. Within any commonhold, views on the appropriate level of maintenance and services will vary. We recognise, however, that for the reasons discussed above, the presence of affordable units within a commonhold which is largely privately owned may cause financial tensions. If the affordable units are shared ownership, the additional cost would fall on the shared owners, who may be particularly likely to be working to tight domestic budgets. If the units were rented out by a social landlord, the landlord might not be in a position to bear the additional cost, but neither might it wish to increase the tenants' rent to cover the extra cost. We therefore provisionally propose the following.

(1) It should be possible for a cap on the cost of improvements and enhanced services to be included in the CCS as a local rule. We do not think that it would be practicable for this cap to apply to repairs, but it would apply to expenditure on (a) improvements to the fabric of the common parts and (b) the provision of substantially enhanced services, such as the example given at 10.27 above. We would expect that, in commonholds which include affordable units, social landlords might wish to negotiate with the developers to include a cap within the CCS. But, more generally, there would be nothing to prevent developers from including a cap in any CCS if they thought it appropriate to the development, and would enhance the saleability of units there.

(2) It should be possible for the cap to be varied or removed by the unit owners by unanimity, or by a resolution which had both the support of 80% of the available votes and the approval of the Tribunal. 35

(3) The figure for a cap imposed in the original CCS (or as subsequently included or varied) would be index-linked.

(4) If any unit owner took the view that proposed expenditure breached any cap – or was otherwise outside the scope of what was authorised by the CCS – then he or she would have to raise this issue before the expenditure was incurred, and make an application to the Tribunal. We are keen to avoid the situation where directors incur expenditure in good faith, and then find that the company cannot validly recover it in full, so leaving a shortfall. 36 The application would be made under the power discussed in Chapter 13.

33 A local rule is a provision in the CCS which is specific to that particular commonhold, rather than one which is required by law to apply to all commonholds.

34 Commonhold Regulations 2004, sch 3, para 4.6.1.

35 Any registered provider of social housing would of course control all the votes allocated to the units which it owned and was renting out.

36 As can happen with leaseholder-controlled companies: see paras 10.6 and 10.30 above.
In Chapter 13 we set out the factors which may be considered by the Tribunal when deciding whether or not to grant a remedy. If the Tribunal decided to grant a remedy, the Tribunal would have power to allow the expenditure to be incurred on that occasion, in spite of the cap. The cap would then remain in place for the future.

If the directors deliberately ignored the cap, and incurred expenditure in breach of it, or disregarded a pending application to the Tribunal, then they would be in breach of their duties as directors and thus potentially liable to the commonhold association. We feel that it is appropriate that they should be personally liable if they deliberately ignore such provisions.

Consultation Question 57.

10.41 We provisionally propose that it should be possible for the CCS to include, as a local rule, an index-linked “cap” on the amount of expenditure which could be incurred on the cost of improvements.

Do consultees agree?

10.42 We provisionally propose that it should be possible for the CCS to include, as a local rule, an index-linked “cap” on the amount of expenditure which could be incurred annually on the cost of “enhanced services”, as described in paragraph 10.40(1).

Do consultees agree?

10.43 We provisionally propose that if a CCS contained such a “cap”, then it could be removed only with the unanimous consent of the unit owners, or with the support of 80% of the available votes, and the approval of the Tribunal.

Do consultees agree?

10.44 We provisionally propose that any application by a unit owner to challenge proposed expenditure should be made before it was incurred, and expenditure should not be open to challenge later.

Do consultees agree?

CONTRIBUTIONS TO THE RESERVE FUND

The current law

10.45 The 2002 Act creates a power for regulations to be made requiring the directors of a commonhold association to set up “one or more funds to finance the repair and maintenance of the common parts”.37

37 CLRA 2002, s 39.
The prescribed CCS does not make the establishment of a reserve fund mandatory, but makes the following provisions.

1. The directors must consider whether a “reserve study” should be commissioned within one year of the commonhold being registered.\(^{38}\) A reserve study is defined as an “inspection of the common parts to advise the directors whether or not it is appropriate to establish or maintain a reserve fund”.\(^{39}\)

2. The directors must commission a reserve study at least once every 10 years.\(^{40}\)

3. Once a reserve study has been commissioned, the directors have a duty to consider the results and decide whether it is appropriate to either establish a new reserve fund, or maintain any existing reserve fund.\(^{41}\)

4. If the decision is made that it would be appropriate to establish a reserve fund, then the directors are under a duty to establish that fund.\(^{42}\)

5. The members of the commonhold association may also require the directors to establish a reserve fund by passing an ordinary resolution.\(^{43}\)

6. Once a reserve fund has been established, the directors must set a contribution to be paid by the unit owners into the reserve fund.\(^{44}\) However, the directors must also ensure the reserve fund does not grow unnecessarily large.\(^{45}\) The directors must:

   a. give notice of the contribution;\(^{46}\)

   b. consider written representations made by unit owners within one month of the notice;\(^{47}\) and

   c. give a further notice specifying the payments to be made and the dates on which they are due.\(^{48}\) Unit owners must be given a minimum of 14 days’ notice to make the first payment.

7. The CCS imposes a duty on unit owners to pay their contribution to the reserve fund as demanded by the directors.\(^{49}\)

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\(^{38}\) Commonhold Regulations 2004, sch 3 para 4.2.6.
\(^{39}\) Commonhold Regulations 2004, sch 3 para 1.4.5.
\(^{40}\) Commonhold Regulations 2004, sch 3 para 4.2.7.
\(^{41}\) Commonhold Regulations 2004, sch 3 para 4.2.8.
\(^{42}\) Commonhold Regulations 2004, sch 3 para 4.2.8.
\(^{43}\) Commonhold Regulations 2004, sch 3 para 4.2.10.
\(^{44}\) The Commonhold Regulations 2004 follow CLRA 2002, s 39 in referring to a reserve fund “ levy”. In this Consultation Paper we refer to the levy as a “contribution to the reserve fund”.
\(^{45}\) Commonhold Regulations 2004, sch 3 para 4.2.11.
\(^{46}\) Commonhold Regulations 2004, sch 3 para 4.2.12.
\(^{47}\) Commonhold Regulations 2004, sch 3 paras 4.2.13 and 4.2.14.
\(^{49}\) Commonhold Regulations 2004, sch 3 para 4.2.15.
10.47 During the lifetime of the commonhold association, the reserve fund cannot be used to pay any debts other than those which relate to the purpose of the reserve fund. However, the reserve fund becomes available to creditors on the winding-up of the association.

**Criticisms of the current law**

10.48 The 2002 Act makes provision for regulations to require the directors of a commonhold association to establish and maintain one or more reserve funds to meet the expenses of the commonhold association.

10.49 The Commonhold Regulations, however, permit rather than require commonholds to have reserve funds. The 2002 Act and the Commonhold Regulations refer separately to contributions to shared costs and contributions to the reserve fund or funds, and permit the setting up of reserve funds, but do not require it.

10.50 The contributions to the shared costs and to the reserve fund or funds are therefore separately identified as different items in the prescribed CCS, where different percentages may be allocated to the contributions to shared costs and to different reserve funds.

10.51 Reserve funds are typically set up to deal with expenditure which does not arise every year, but which it is foreseeable will arise in the future. Examples would include:

1. Exterior redecoration. If it is known that exterior redecoration will be necessary every, say, five years, it would be prudent to estimate the likely cost when it is to be carried out. One fifth of the likely cost would then be collected every year, and put in a reserve fund.

2. Lift renewal. If it is estimated that a lift will be beyond economic repair, after, say 40 years, a sum could be set aside each year to meet the likely future cost. Inevitably, what is set aside for something of this kind is more speculative, as it may turn out that the lift will require replacement in 35 or 50 years. However, the expected period, for which the lift will last before requiring replacement, can be kept under review.

10.52 The 2002 Act does not make any provision for reserve funds which have been set up for one purpose to be used for any other. The implication of the relevant section is that it is not permissible to do this. The section provides that the assets of a reserve fund shall not be used for the enforcement of any debt except a judgment debt referable to a reserve fund activity. But it has been noted that the provision is ambiguous. It is not

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50 CLRA 2002, s 39(4). Possible alternative interpretations of this are set out at para 10.52 below.

51 CLRA 2002, s 56.

52 CLRA 2002, s 39.

53 Referred to as the “commonhold assessment”: CLRA 2002, s 38.

54 The contributions to the reserve fund are referred to as a “levy”: CLRA 2002, s 39(2).

55 Commonhold Regulations 2004, sch 3 annex 3, paras 1 and 2.

56 CLRA 2002, s 39(4).
clear whether it means that the fund is available only to meet a judgment debt referable to that particular reserve fund activity, or that it is available to meet a judgment debt referable to any reserve fund activity. The former would appear to be the more reasonable interpretation but, if that were what was intended, it could have been made explicit if the legislation had referred to “that reserve fund activity”. The section is, however, silent on whether the commonhold association may choose to use a reserve fund set up for one purpose for some other purpose. Commentators differ as to whether this is possible, and the present position is unclear.57

10.53 It has already been noted that the same consultation procedure applies to contributions to the reserve fund(s) as applies to the contribution to shared costs.58 There is no provision for a contribution to be required for the reserve fund on an emergency basis, that is, without prior consultation, as the need for one would not arise.59

10.54 No respondents to the Call for Evidence have drawn our attention to any particular problem with the operation of these “reserve fund” provisions within commonholds. Some managing agent respondents drew our attention to the problems that arise when they are managing properties on behalf of leaseholder-controlled companies.60 They said that sometimes they (or experts commissioned by them) make recommendations in respect of the setting up or funding of reserve funds, which directors then decline to follow.

10.55 We have noted in Chapter 7 at paragraphs 7.17 to 7.19 the difficulties that would arise if a commonhold association should become insolvent. We have also expressed our concern that, wherever possible, steps should be taken to ensure that the insolvency of a commonhold is a very rare event. Ensuring that commonhold associations have adequate reserve funds seems to us to be an important way to achieve this aim.

10.56 One way of doing this would be to go further than the current law and to require all commonholds to have a reserve fund. If we do so, then we need to distinguish between (1) general reserve funds and (2) specific reserve funds.

1) A general reserve fund would, in effect, be a fund which the commonhold association has put aside for the future. It would not necessarily have been set aside for a specific purpose, and calculated on that basis.

2) A specific reserve fund would be a reserve fund which has been set aside for a specific purpose, such as the cost of exterior redecoration in five years’ time, or the cost of replacing a lift in 40. In each case then, ideally, the likely future cost

57 Clarke on Commonhold takes the view, at 17[14] that the commonhold association could decide to use a reserve fund for other purposes; Aldridge, Commonhold Law (loose-leaf ed 2002) takes the view (at 3.3.15 and 3.3.19) that the fund must be used exclusively for the designated activity.

58 See para 10.25 above.

59 Unlike for the contribution to shared costs: Commonhold Regulations 2004, sch 3, 4.2.5.

60 The Leasehold Reform Group (a self-formed industry group, see ch 3, n 24) referred to their survey of managing agents which suggested that this occurred.
will be estimated, and the annual contributions calculated by dividing that sum by the relevant number of years.61

10.57 It seems difficult to insist by regulation that a commonhold association should have to set up separate reserve funds for different items of foreseeable future expenditure, as what will be required will depend on the physical structure of the commonhold. Reserves are often set aside – either in one fund or separate funds – for the eventual replacement of items such as flat roofs and lifts, but not all buildings have these elements. Virtually all buildings will need some expenditure on exterior redecoration, which is likely to be needed regularly, though not every year.

10.58 If a reserve fund is set up, then various questions will arise:

1. whether it should be possible for the directors of the commonhold association to use a reserve fund which has been accumulated for a designated purpose for another, and, if so, on what terms;

2. whether the reserve funds should be held on some form of statutory trust, similar to that imposed on leasehold service charges;62

3. whether the reserve fund should be protected from creditors, if a claim is made against the association;

4. whether the reserve funds should receive any protection if the commonhold association should become insolvent; and

5. if it is decided to offer protection to reserve funds in scenarios (3) and (4) above, whether any safeguards should be put in place to prevent the association from abusing such protection.

10.59 If we are going to protect reserve funds from being seized by creditors,63 then it will be easier to give this protection if the reserve fund is a specific reserve fund rather than a general reserve fund. If a reserve fund has been set up for one purpose, it seems reasonable to say that it should not be seized in respect of a debt incurred for some other purpose. It would also be possible to provide that, on the insolvency of a commonhold association, it should be used first to cover debts relating to the purpose for which it has been designated. With a general reserve fund, it would not seem reasonable to protect it from all claims against the commonhold association, as it would be impossible to be sure of what it had been intended to cover.

61 It is recognised that the cost of replacing, say, a lift a long time into the future will be somewhat speculative, and that, in practice, inflation, and interest rates will need to be taken into account; but the example illustrates the broad approach. Reserve funds which are set up to cover the eventual cost of specific projects are sometimes referred to as "sinking funds", rather than "reserve funds" but the two terms often seem to be used interchangeably.

62 Landlord and Tenant Act 1987, s 42.

63 We are thinking here of the possibility of a judgment creditor obtaining a third-party debt order against the commonhold association's bank account.
Proposals for reform

10.60 Although the present provisions lean in favour of there being a reserve fund, it is difficult to envisage circumstances when it would not be appropriate for a commonhold to have at least some reserves.\footnote{Para 1.149(1) to (3) above.} We therefore propose that the CCS be amended to provide for all commonholds from the outset to have a reserve fund. We do not propose making any change to the current requirement in the CCS that the directors should have to commission a reserve fund study from time to time.\footnote{Commonhold Regulations 2004, sch 3, paras 4.2.6 and 4.2.7.}

10.61 We do not think it is possible to specify that a commonhold association should have to raise a specified amount each year towards its reserve fund.\footnote{We are not recommending any change to the position under the CLRA 2002 where they are separately requested.} The circumstances of each commonhold will simply be too diverse and variable. We hope that the existence of the reserve fund, and the fact that it would appear on the annual accounts of the commonhold association, would at least serve as reminder of the need for one, and prompt unit owners to raise the question of why contributions were not being made towards it.

10.62 In addition to its being compulsory for a commonhold association to have a general reserve fund, the directors should be able to set up reserve funds dedicated for specific purposes (“designated reserve funds”) as they might see fit, and that members should also be able to require that such funds be set up. This should be by an ordinary resolution, as it is at present.\footnote{Commonhold Regulations 2004, sch 3, para 4.2.10.} If a commonhold is sub-divided into sections (in order to separate out the management of different interests such as commercial and residential interests) as we propose in Chapter 5 at paragraphs 5.39 and following, then any section could require, by an ordinary resolution of the section that a reserve fund or funds be set up for a designated purpose within its section, with the contributions towards it being made by that section.

10.63 We have noted above the ambiguity in how far reserve funds are protected from being taken by creditors who obtain a judgment against the association.\footnote{See para 10.52.} We think the position should be clarified by providing that any designated reserve funds should be clearly “earmarked” for their purpose, and should be protected from being taken in respect of a judgment relating to some other purpose.

10.64 The fact that designated reserve funds would enjoy this protected status would be an incentive to the directors of commonhold associations to establish them. By and large, we consider that this would be beneficial, as it would:

(1) encourage commonhold associations to think about making prudent provision for long-term liabilities;
(2) give them a financial incentive to do so; and
(3) lessen the likelihood of commonhold associations becoming insolvent.

10.65 In the event that the commonhold became insolvent (as discussed in Chapter 7) then any designated reserve funds could be used only to meet liabilities which fell within the intended scope of the fund. It would therefore be essential for the purpose or purposes of reserve funds to be clearly designated in the accounts of the association.

10.66 We have already expressed the view that it is not in principle appropriate to give trust status to reserve funds.\(^{69}\) Having discussed reserve funds in this chapter in more detail, we further take the view that it would unduly complicate matters to attempt to do give them trust status. If reserve funds were held on a trust for the general purposes of the commonhold,\(^{70}\) it would be difficult to “earmark” them for a designated purpose.\(^{71}\) We think that “earmarking” them for a designated purpose will give them better protection. It can more readily protect the funds from a creditor who is trying to enforce a judgment which relates to a different matter.\(^{72}\) It can also mean that, if the commonhold association should become insolvent, a designated reserve fund can be used first to satisfy any debts that relate to the purpose for which it has been set up.

10.67 If the members resolved to terminate the commonhold voluntarily (as discussed in Chapter 15), then all the reserve funds would normally, along with the other assets, be divided in the proportions set out in the termination agreement. As termination assumes that the commonhold is solvent, it would very rarely, if ever, be necessary to take account of the terms upon which they were held.\(^{73}\) If necessary, earmarking would be applied, but normally this would be relevant only in the two circumstances set out in the preceding paragraph.

10.68 In exchange for giving designated reserve funds a high level of protection from creditors, we think that neither the directors nor the members should be permitted to change the purpose of the reserve without a fairly high level of formality. We provisionally consider that, once the fund had been set up, its objects should be changed only with the consent of 80% of the membership of the commonhold association, plus the approval of the Tribunal. This requirement would primarily be to protect the interests of the minority who did not support the change, but the Tribunal would also be alert to the possibility of the commonhold association changing the designation of a reserve fund at the last minute to protect it when faced with legal proceedings and/or the threat of insolvency. For this reason, we think that the approval of the Tribunal should be required even if the proposed change has the unanimous support of the members.

10.69 There would then remain the question of whether, in the case of an emergency, the directors should be able to “borrow” from one reserve fund in order to meet some other

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\(^{69}\) See ch 7 paras 7.64 to 7.66.

\(^{70}\) Under Landlord and Tenant Act 1987, s 42, service charge funds are held primarily for the purposes for which they have been collected.

\(^{71}\) See paras 10.62 and 10.63 above.

\(^{72}\) See paras 10.63 and 10.65 above.

\(^{73}\) The directors of the commonhold association would be required to make a “Declaration of Solvency” before the commonhold could be voluntarily terminated: CLRA 2002, s 43(1)(a) and Insolvency Act 1986, s 89.
pressing financial need of the association. Our provisional view is that they should be entitled to do so. They would, under their internal accounting, be under an obligation to "repay" what they had "borrowed". Therefore, borrowing ought not to affect the position if the commonhold became insolvent or was voluntarily terminated. If they wish to use a reserve fund for a different purpose, they should, however, be required to go through the same procedure that is needed to change the purpose for which a reserve fund is used.

10.70 The 2002 Act treats the contributions to shared costs and the contributions to the reserve fund or funds as separate entities. Nevertheless, it would seem convenient to require that the consultation on the contributions to the reserve fund(s), and the approval of them, should take place at the same time as the consultation on, and approval of, the contributions to shared costs.
Consultation Question 58.

10.71 We provisionally propose that it should be compulsory for a commonhold association to have some form of reserve fund.

Do consultees agree?

10.72 We provisionally propose that the scheme for the financing of the commonhold should continue to distinguish between contributions for shared (current) expenditure, and contributions to the reserve fund or funds.

Do consultees agree?

10.73 We provisionally propose that no minimum annual contribution towards the reserve fund should be specified.

Do consultees agree?

10.74 We invite consultees who do not agree to suggest how a requirement for minimum contributions might operate.

10.75 We provisionally propose that the directors of commonhold associations should be able to set up such designated reserve funds as they see fit.

Do consultees agree?

10.76 We provisionally propose that it should also be possible for the members of a commonhold association to require, by ordinary resolution, that a designated reserve fund or funds should be set up.

Do consultees agree?

10.77 We provisionally propose that designated reserve funds should be protected from enforcement action by creditors, unless their claim relates to the specific purpose for which the designated reserve fund was set up.

Do consultees agree?

10.78 We provisionally propose that designated reserve funds should continue to receive equivalent protection if the commonhold association should be subject to insolvency proceedings.

Do consultees agree?

10.79 We provisionally propose that it should be possible to change the designation of a designated reserve fund only by a resolution supported by 80% of the members, and with the approval of the Tribunal.

Do consultees agree?
10.80 We invite consultees' views as to whether the directors (or the members in a general meeting) should be able to “borrow” from a reserve fund in order to meet a shortfall in meeting other expenditure, and, if so, what safeguards, if any, would be appropriate.

10.81 We provisionally propose that the proposed annual contributions to the reserve fund or funds should be approved by the members in the same way as the contributions to current expenditure, and, if possible, at the same time.

Do consultees agree?

SHARES OF THE CONTRIBUTIONS TO BE PAID BY EACH UNIT

The current law

10.82 Contributions to the shared costs and the reserve fund are divided between units in percentages specified by the CCS. The percentages allocated need not (and often will not) be equal, but must total 100%. A larger unit could therefore be required to pay a larger percentage of the commonhold contributions. Those establishing the commonhold must insert the percentage contributions which must be paid by each unit. There are two separate percentages which must be set out regarding financial matters:

(1) paragraph one sets out the percentage of the regular contribution to shared costs allocated to each unit;\(^\text{74}\) and

(2) paragraph two sets out the percentage of the contributions to the reserve fund or funds which are to be paid by each unit.\(^\text{75}\)

10.83 They are therefore separately identified as different items in Annex 3 of the prescribed CCS,\(^\text{76}\) where different percentages may be allocated to the contributions to shared costs and to the different reserve funds.

10.84 The Act seems to envisage that all the expenses of the commonhold association will be met in the same proportion.\(^\text{77}\) This impression is reinforced by the CCS.\(^\text{78}\) There is no flexibility to vary the percentage allocated to a particular unit in relation to different “heads” of cost. The implications of this are discussed at paragraphs 10.87 to 10.88.

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\(^{74}\) Commonhold Regulations 2004, sch 3 para 3.2.1.

\(^{75}\) Commonhold Regulations 2004, sch 3 para 3.3.1.

\(^{76}\) Commonhold Regulations 2004, sch 3 annex 3, paras 1 and 2.

\(^{77}\) CLRA 2002, s 38.

\(^{78}\) Commonhold Regulations 2004, sch 3 annex 3, para 1. A single box is provided in which to insert the percentage of the contribution to shared costs which must be paid by each unit.
Varying percentages of contributions to shared costs

10.85 The percentage of contributions to shared costs, or of the contributions to the reserve funds allocated to a particular commonhold unit, can only be amended by a special resolution.\(^{79}\)

10.86 A unit owner has the right to prevent the percentage they are required to contribute being altered if this would be to “allocate a significantly disproportionate percentage of the [commonhold contributions] to his commonhold unit.”\(^{80}\)

Criticisms of the current law

10.87 We have noted at paragraph 10.84 above that the 2002 Act seems to envisage that all the expenses of the commonhold association will be met in the same proportion.\(^{81}\) This lack of flexibility has been criticised, as it does not seem possible to vary the percentage allocated to a particular unit in relation to different “heads” or elements of cost.\(^{82}\) In larger commonholds it may be necessary for the commonhold contributions to be divided into various “heads”. To take a simple example, flats which do not have a parking space may not be required to contribute to the costs associated with a basement parking area. We refer to the ability to separate out different “heads” of the commonhold costs as a “divided contribution”.\(^{83}\)

10.88 Some commentators have suggested that a divided contribution is permissible,\(^{84}\) but two respondents to our Call for Evidence suggested that inflexibility in dividing costs between unit owners was a defect of the current law.\(^{85}\) It has been pointed out that it would appear that reserve funds can be set up for different purposes, and the liability to contribute towards them could be allocated in different ways. It has been suggested that this could be used as a way of getting around the fact that the 2002 Act does not appear to make provision for a divided contribution.\(^{86}\) Other writers have drawn attention to the potential problems that this might cause.\(^{87}\)

\(^{79}\) Commonhold Regulations 2004, sch 3 para 4.8.11 (3). A special resolution requires either 75% of the votes cast to be cast in favour if the vote is taken at a meeting, or 75% of all votes in the commonhold to be cast in favour if the written resolution procedure is used.

\(^{80}\) Commonhold Regulations 2004, sch 3 para 4.8.12.

\(^{81}\) CLRA 2002, s 38.

\(^{82}\) Commonhold Regulations 2004, sch 3, Annex 3, para 1. A single box is provided in which to insert the percentage of the contribution to shared costs which must be paid by each unit.

\(^{83}\) This borrows a term used in Clarke on Commonhold, 17[3], which describes the shortcomings of the current law. Other commentators have made similar observations.

\(^{84}\) Aldridge, Commonhold Law (loose-leaf ed 2002) 3.3.26A to 3.3.26C.

\(^{85}\) Mr Graham Paddock, a South African legal expert on commonhold-type schemes, and the Leasehold Reform Group, a self-formed industry group (see ch 3, n 24).

\(^{86}\) In Commonhold – Guidance on the drafting of a Commonhold Community Statement including Specimen Local Rules (DCA December 2004). Commonhold Regulations 2004, sch 3, Annex 3, para 2 appears to allow for a single unit to contribute differing percentages towards the different reserve funds.

\(^{87}\) See Clarke on Commonhold, 17[13].
Varying percentages of contributions to shared costs

10.89 We are not aware of the provisions of the current law having presented any serious problems. Commentators have noted that a unit owner’s right to prevent the percentage he or she is required to contribution to shared costs being altered if this would be to "allocate a significantly disproportionate percentage" of the commonhold contributions to his or her commonhold unit is somewhat vague.\(^{88}\) Opinions will inevitably differ as to what is "significantly disproportionate" and what are the "circumstances of the case".\(^ {89}\) The right of challenge appears to arise only if the percentage contribution is changed: there is no right to challenge what was allocated in the original CCS. It is also unclear whether "the circumstances of the case" could be used to justify an apparently unfair re-allocation of expenses, on the basis that it was based upon what had been originally agreed.

10.90 If developers are able comprehensively to allocate the necessary expenditure when a commonhold is set up, it would be assumed that prospective buyers would be advised on its implications for them before they become legally committed to their purchase. Similarly, if on converting an existing building to commonhold the owners have agreed how expenditure is to be divided, it would be difficult to justify that a court or tribunal should be able to intervene.

10.91 There may, however, now be a greater need to establish guiding principles in this area than when the 2002 Act was passed. It has become clear to us that we need to build in more flexibility in accommodating more complex commonholds. We are told that sometimes developers do not know when a development is begun what its full extent will be. They may not be clear whether certain plots of land will be available for development or not. If they wish the additional land to form part of the same commonhold, it may be possible to accommodate this by the use of development rights, which would enable developers to vary the percentage of the contributions to shared costs, and to the reserve funds, which are allocated to each unit. We are considering, however, whether it would be appropriate to specify some general provision to operate by default, or at least as general guidance.

Proposals for reform

10.92 We have noted at paragraphs 10.87 and 10.88 the criticism that the 2002 Act seems inflexible in not permitting a divided contribution. We do not think the possible use of reserve funds to make up for this shortcoming is desirable, as it seems to misuse the concept of a reserve fund.\(^ {90}\) It also seems liable to cause confusion.

10.93 For larger or more complex developments it may be appropriate to adopt sections, as provisionally proposed in Chapter 5, at paragraphs 5.39 and following, to provide the necessary flexibility. In other cases, however, a commonhold may not want to have separate sections, or the criteria for creating sections are not met. The commonhold nevertheless may want to have greater flexibility over the contributions paid by an individual unit towards different costs. Having sections will inevitably involve a degree of complexity, and having a divided contribution may offer a more straightforward approach.


\(^{90}\) Referred to in para 10.88 above.
solution. To take the example given in paragraph 10.87 above, the owners of the flats without parking spaces might well object to having to pay the costs associated with them. Having a divided contribution would address this issue. The owners of the flats without parking spaces would still be able to vote on issues relating to them. To avoid this result, it would be necessary to set up the commonhold with sections. Sections would allow costs to be separated out, but would additionally mean that unit owners would be allowed to vote only on expenditure which was relevant to them. In example such as the parking spaces, having a divided contribution might be thought a reasonable compromise, which would avoid the complication of having sections.

10.94 We therefore provisionally propose that it should be possible to allocate to individual units within a commonhold different percentages that they must contribute towards different heads of cost. The allocated percentages for each head of expenditure would have to add up to 100%. In practice we think it likely that the different percentages will be allocated on the basis that certain specified heads of expenditure are borne only by specified units in the specially enumerated proportions, and that the remainder of the expenditure is borne by all the units in the proportions which generally apply.

10.95 We invite the views of consultees as to whether each commonhold should have total flexibility in how different costs are allocated, or whether there should be any limitations on this freedom.

Consultation Question 59.

10.96 We provisionally propose that it should be possible to allocate to individual units within a commonhold different percentages that it must contribute towards different “heads” of cost.

Do consultees agree?

10.97 We invite consultees’ views as to whether each commonhold should have total flexibility in how different costs are allocated, or whether there should be any limitations on their ability to do so.

Varying percentages of contributions to shared costs

10.98 We are considering here how unit allocations (of financial contributions) are varied from how they were originally set in the CCS. Although either floor area or capital value would offer consistent default bases upon which to allocate expenditure, factors such as whether a flat is on the ground floor or the seventh floor may affect capital value, but do not provide a rational basis upon which to determine the allocation of contributions. Floor area is a plausible method of allocating expenses in default, but it is not clear to us that it would be an appropriate way of dividing expenditure between residential and non-residential units, or between different types of commercial units. Floorspace on its own may not be an appropriate criterion when commercial units may have more headroom than residential units, and other factors may also be relevant.
10.99 We note that our provisional proposal in Consultation Question 60 would mean that the unit owner’s right to apply would now be to the Tribunal, in accordance with our general proposal in Consultation Question 78 at 13.76 in Chapter 13.

**Consultation Question 60.**

10.100 We provisionally propose to retain the possibility of varying the percentage of expenditure allocated to each unit, by amending the CCS by special resolution. Such amendments would remain subject to a unit owner’s right not to have a significantly disproportionate amount of the contributions to shared costs, or the reserve funds, allocated to his or her unit.

Do consultees agree?

10.101 We invite consultees’ views as to whether:

(1) it is likely to be fair and workable to consider any proposed variations to contributions to shared costs, and the reserve funds, on the basis that the originally allocated percentage was fair; and

(2) safeguards need apply only if the allocated percentage is altered.

10.102 We invite consultees’ views as to whether internal floor area would offer a satisfactory default basis on which to allocate financial contributions in purely residential commonholds.

10.103 We invite consultees’ views as to whether internal floor area would offer a satisfactory default basis on which to allocate financial contributions in commonholds which include (a) commercial and residential units and (b) commercial units of different kinds. If not, we invite views on alternative methods.

**LIABILITY ON THE TRANSFER OF A UNIT**

**The current law**

10.104 A basic principle of commonhold is that unit owners should owe duties to the commonhold association and to their fellow unit owners only so long as they actually own a unit. A provision in the CCS which purported to provide otherwise would be void. Similarly, a new unit owner should automatically owe those duties on becoming the owner. This scheme is intended to ensure that the benefit and burden of positive obligations (such as to pay money or repair) should automatically run with the units.

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91 CLRA 2002, s 16(2).
92 CLRA 2002, s 16(3)(a),
93 CLRA 2002, s 16(1).
94 “Positive covenant” is explained further in the Glossary.
10.105 Many commonhold duties can of course only in practice be performed, and are only of any relevance, so long as the unit owner does actually own a unit. Financial obligations, on the other hand, raise slightly different issues. Before the Commonhold Regulations were issued, some commentators were concerned about how making a unit owner liable only so long as he or she owned the unit would operate if a unit were sold. If the former unit owner left owing commonhold contributions, the new owner would not be liable for them. It might, however, be difficult in practice to trace the former unit owner and enforce payment. It was further suggested that it would be possible for a unit owner to evade payment of arrears simply by transferring a unit to an associate or an associated company. This would increase the possibility that the commonhold association might become insolvent.

10.106 A former unit owner and a new owner may, under their sale and purchase contract, agree, as between themselves, who should bear any financial obligations. Further, there is nothing in the 2002 Act which prohibits the new owner becoming liable for the arrears of contributions owed by the former owner. The concerns of commentators (expressed in the preceding paragraph) were therefore addressed by the CCS, which allows the commonhold association to serve notice on a new owner, requiring him or her to pay the arrears owed by any former unit owner.

10.107 Whilst at first sight this liability may appear unfair on the new owner, the CCS provides a route whereby the new owner may ensure that his or her obligations in this respect are defined and limited. A unit owner may request the association to issue a Commonhold Unit Information Certificate ("CUIC"). The CUIC is a prescribed form, which must set out the amount of the commonhold contributions which are owing in respect of the unit. The commonhold association is then under an obligation to provide the CUIC within 14 days. The association cannot then seek to recover from the incoming owner more (in respect of the period up to the date of the CUIC) than has been set out in the CUIC. It is clearly intended that the current owner has to request this form, but it is also assumed that the conveyancers acting for the new owner will insist on seeing a copy of it. The parties' conveyancers will then be able to ensure that any arrears are dealt with on completion of the sale. This could be by:

(1) the current unit owner clearing all arrears before the transfer takes place;

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96 CLRA 2002, s 16(2) and s 16(3)(a).


98 CLRA 2002, s 16(1)(a).

99 Commonhold Regulations 2004, sch 3, para 4.7.3. This procedure would be redundant if our proposals for the commonhold association to have a statutory charge for unpaid contributions are implemented (ch 14 paras 14.47 to 14.71. G Fetherstonhaugh, M Sefton, and E Peters, *Commonhold*(2004), 4.13.5 points out that the obligation arises "following a transfer", and is not therefore dependent upon registration of the new owner’s title at HM Land Registry, or upon the new owners or their conveyancers giving notice of transfer to the association.

100 Commonhold Regulations 2004, sch 3, para 4.7.1.

requiring the current unit owner’s conveyancer to undertake to clear the arrears from the proceeds of sale; or

the making of an allowance on completion so that the arrears can be paid by the new unit owner.

10.108 The intention is that, if these procedures are followed:

(1) arrears owed to the commonhold association will be met; and

(2) by allowing the commonhold association to make the new owner liable, he or she will in practice then ensure that the outgoing owner meets his or her share.

**Criticisms of the current law**

10.109 Although the provisions included in the CCS largely address the perceived deficiencies in section 16 of the Act, which are set out in paragraph 10.105 above, at least one commentary has suggested that some deficiencies remain. Possible problems are noted below.

(1) The CUIC will be issued in response to the current owner’s request, and will therefore very probably be issued some time before the completion date. The new owner will be liable for payments which fall due after that date, but may be unaware of them.

(2) If the commonhold association delays issuing the CUIC, there is little that the current unit owner can do to expedite matters. In theory the owner could make an urgent application to the court for an order requiring the association to comply with the provisions in the CCS, but it may not be practicable to do so.

(3) It may be necessary to obtain more than one CUIC, as a prudent conveyancer acting for a seller may wish to obtain one before exchanging contracts, and particularly if exchange or completion should be delayed – the conveyancer acting for the buyer may insist on a more up-to-date one. It is not clear whether a commonhold association, having provided one CUIC, can then refuse to provide another if a further request is made, or how long must elapse before it can be required to provide another. More than two CUICs may in practice be requested, if either exchange of contracts or completion be delayed.

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102 An undertaking given by a conveyancer must be observed as a matter of professional conduct, and court procedures exist to ensure that they are promptly complied with.

103 This would take the form of an agreed deduction from the money due on completion.

104 Clarke on Commonhold, 15[17].

105 The completion date is the date when the buyer pays the purchase price in full, receives the transfer deed signed by the seller, and is given possession of the property. Although he or she does not receive legal title until the transfer deed is registered at HM Land Registry, his or her conveyancer is, after completion, in a position to register the transfer (after paying any Stamp Duty Land Tax).

106 Ie, an order for specific performance. It is arguable whether the order should be an injunction or for specific performance: the CCS has contractual force, but it is contained in a statutory instrument.
A leasehold service charge is generally set to be payable at the same rate throughout the relevant financial year, and it is not common for there to be a provision for a supplemental charge to be made. It is to be hoped that it will not be encountered frequently in commonhold, but provision is made for an association to make an emergency request for a contribution to the shared costs. This request could be made after the CUIC is issued, but before the sale is completed. Although being able to make an emergency request for a contribution to shared funds may have inconvenient consequences on the transfer of a unit, we think that it needs to remain possible for a commonhold to raise funds in this way.

A similar problem could arise with contributions to reserve funds. Contributions to the reserve fund or funds are likely for convenience to be collected at the same time as the contribution to current shared costs, but they could be imposed at any time of the year. A general meeting might approve the contribution to shared costs for the year, but postpone approval of the contribution to the reserve funds for further consideration. The contributions to the reserve funds would then fall due at different times, and might become due after the CUIC had been issued.

In their response to our Call for Evidence, the Building Societies Association explained that, when lending on commonhold units, they require conveyancers acting for their members to “obtain a commonhold unit information certificate and ensure that all of the [contribution to shared costs] in respect of the property has been paid up to the date of completion”. If the inference to be drawn from the requirement is that the CUIC will itself be conclusive, then it will in practice be impossible for the conveyancer to comply. The CUIC will generally have to be issued a few days before completion, and on the basis of what is set out in the preceding sub-paragraphs, a conveyancer would have to rely on assurances given by the seller’s conveyancer immediately before completion of the purchase takes place.

Clearly, provision should be made in the sale and purchase contract for matters such as those set out in paragraph 10.109(5) and (6) above. That does not, however, address the point that buyers could find themselves liable to pay sums which were not included in the CUIC, and then having to recover a proportion from the seller. Again, it is possible that a prudent conveyancer acting for a buyer could guard against this eventuality by always insisting on a retention, but it would be inconvenient if retentions had to be made in commonhold conveyancing as a matter of course.

Other issues may also arise. The commonhold association is under a legal duty to provide a CUIC on request. No provision is made for the association to make any charge. Particularly if it is necessary to issue more than one CUIC with each sale, the

107 A “retention” here would be a sum of money held by a conveyancer as “stakeholder” in its technical, legal meaning. It would be a sum of money to be held by a conveyancer pending the outcome of an event: in this case, agreement on how what was owed to the commonhold association should be borne by the buyer and the seller.

108 Commonhold Regulations 2004, sch 3, para 4.7.2.
directors and/or the managing agents of the commonhold may feel that it is unreasonable that the costs of providing the CUIC cannot be recovered.

10.112 Finally, an issue has been identified over the position if a mistake is made by the commonhold association in issuing a CUIC. The new unit owner can rely on that, and cannot be held liable for any greater sum than the figure given in the CUIC. It is suggested, however, that it is not clear whether the new owner must have actually seen the CUIC in order to be able to rely on it, or whether the mere fact it has been issued "wipes the slate clean", and the commonhold association cannot then recover any deficit from the new owner.

Proposals for reform

10.113 There does seem to us to be a real risk that either a contribution to the reserve fund(s) or an emergency contribution to shared costs could become due after a CUIC has been issued, but before completion. The new owner would then be liable for the sums due, and would have to recover a proportionate share from the seller. It is also possible that the contribution would have been agreed, but no demand notice served, before the purchaser completed the purchase.

10.114 We have considered whether it would be possible to have some form of “protected period” which provided that no new contribution would become due in respect of a unit for a period of, say, 14 days after the issue of a CUIC. We do not, however, think it would be practicable to do so. In some commonholds of, say, 200 units, more than 10% could well change hands in any year. The “protected periods”, when aggregated, might take up most of the year.

10.115 The potential problem for the purchaser could, however, be substantially mitigated. Under the current law, the CUIC is issued at the request of the current unit owner, although it will, in practice, be requested by the owner’s conveyancer. We consider that if a commonhold association should resolve to serve either:

(1) an emergency request for a contribution to shared costs; or

(2) a request for a contribution to a reserve fund or funds;

within a specified period after the issue of a CUIC, then it should also be obliged to serve the request on the current owner's conveyancers (whose details would be on the CUIC). The outgoing owner’s conveyancer would thus be aware of it, and would be in a better position to respond to a request by the buyer's conveyancer to confirm what was due at the completion date. If the association failed to serve the request on the conveyancer, then the sum would not be recoverable from the purchaser.

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109 Clarke on Commonhold, 15[17].

110 It is suggested by Clarke on Commonhold, 15[17] that the latter would apply, on a literal reading of the Commonhold Regulations 2004, sch 3, para 4.7.4, although it is a somewhat counter-intuitive outcome.

111 Commonhold Regulations 2004, sch 3, para 4.7.1.

112 Using Form 2, Form 3 or Form 4 in sch 4 to the Commonhold Regulations 2004.
10.116 *We* think this scheme strikes an appropriate balance between protecting the new unit owner from unexpected liabilities, and giving the commonhold association a route to ensure that a new owner is liable.

10.117 Issuing a CUIC will involve some work by the commonhold association, or their managing agents. Under the current law, there would seem to be no disincentive to outgoing unit owners in requesting several CUICs at different stages of a sale transaction. We provisionally propose that the prescribed CCS should enable the commonhold association (or its managing agents) to charge for its costs in issuing a CUIC. In view of the difficulties that arise in leasehold transactions, where it is alleged that excessive fees are demanded, we also provisionally propose that a maximum fee should be prescribed for providing a CUIC.
Consultation Question 61.

10.118 We provisionally propose that the current scheme for the issue of a Commonhold Unit Information Certificate (“CUIC”) on the sale of a unit should in its essentials be retained.

Do consultees agree?

10.119 We invite consultees’ views as to whether the possibility of further contributions (emergency contributions, or contributions to the reserve fund or funds) falling due after the issue of a CUIC is likely to present practical problems to conveyancers.

10.120 We provisionally propose that, once a CUIC has been issued, an incoming unit owner should not be liable for further contributions which fall due, unless the commonhold association or its agent has notified the current owner’s conveyancers of the further liabilities.

Do consultees agree?

10.121 We provisionally propose that the maximum fee for a commonhold association to issue a CUIC should be set by regulation, and kept under review.

Do consultees agree?

10.122 We invite consultees’ views as to whether the lack of any sanction or convenient remedy for the failure on the part of the commonhold association to issue a Commonhold Unit Information Certificate within the prescribed 14-day period is likely to cause problems in practice.

10.123 We further invite consultees’ views on how best this may be resolved.

10.124 We invite consultees’ views as to whether a Commonhold Unit Information Certificate should be conclusive once issued; or whether it should be possible for it to be amended if an error is spotted after it has been issued.

10.125 We further invite consultees’ views on what problems would arise in practice if a Commonhold Unit Information Certificate could be amended; and on how these might be addressed.
Chapter 11: Responding to emergencies

INTRODUCTION

11.1 Most of the financial obligations that will be faced by a commonhold association are foreseeable. The day-to-day costs of running the commonhold are met through the contribution to shared costs, while contributions to reserve funds can be collected to meet substantial foreseeable expenses in the future, such as the eventual need to replace a roof or a lift at the end of its expected lifetime. A commonhold association may, however, find that it is faced with unforeseen expenses following an emergency.

11.2 Some emergencies, such as storm damage, may be covered by insurance. General “wear and tear” may result in modest bills which can comfortably be met by the unit owners (for example, a small leak in a roof). Other emergencies may result in substantial bills.

11.3 The Grenfell Tower fire was a tragedy in which a devastating loss of life was caused by fire spreading rapidly through external cladding on a residential building. The aftermath of the fire has brought into sharp focus the financial costs that can arise when significant defects are found in buildings. In response to our Call for Evidence, our attention was drawn to several examples where leaseholders are faced with substantial bills to deal with the removal of cladding.

11.4 As we have explained in Chapter 1, in some instances the costs of replacing cladding have been met by developers or by the National House Building Council (“NHBC”). Where that is not the case, the costs will ultimately fall on the freeholders or leaseholders. Although Government has sought to impose a “moral duty” on freeholders, leaseholders may be legally responsible under the terms of their lease.¹ The works will need to be carried out as soon as possible, and precautions taken in the interim,² so emergency funding may be required even if it is possible eventually to recover the costs. Some respondents have drawn our attention to cases where substantial institutional freeholders have been able to lend residents’ management companies, or right to manage companies, the necessary funds. They have pointed out that this source of funding is not possible in the absence of an external freeholder and is not available in a commonhold, as there is no one beyond the unit owners upon whom one can fall back.

11.5 Although the consequences of the Grenfell Tower fire offer a particularly serious example of the need for expensive unplanned action to be taken quickly, other examples can be expected to arise from time to time. It is therefore necessary to consider how commonhold can manage such emergency expenses.

¹ Leaseholders of flats at Cypress Place and Vallea Court, Manchester v Pemberstone Reversions (5) Ltd [2018] UKFTT 0016 (PC), REF/2018/0016.

² For example, in some cases it has only been possible to avoid the expense and inconvenience of evacuating a building pending removal works by employing security staff to be on round-the-clock fire watch duties.
11.6 This issue is fundamentally concerned with the ability of the commonhold association to raise funds. As a matter of law, it seems that commonhold unit owners and leasehold owners are in exactly the same position: both are ultimately liable to fund any emergency costs. As noted in paragraph 11.4 above, some leaseholders have benefited from the willingness of the freeholder to offer funds voluntarily. In some cases the freeholder has provided that funding only in the form of a loan. Some freeholders have gone further and have agreed to cover the costs themselves, without seeking to recover the money from leaseholders. Such intervention will not be available in a commonhold where there is no freehold investment to protect. Commonhold may of course still benefit from the intervention of a developer in order to protect its reputation and enhance the integrity of future developments, or the costs may be covered by the NHBC.

11.7 Unit owners therefore appear to be in a weaker position than some leaseholders in respect of emergency expenditure, albeit that many other leaseholders are offered no assistance by their landlords. The question therefore arises as to how unit owners in a commonhold might respond to an emergency.

THE CURRENT LAW

11.8 If the emergency expenditure is not particularly large, then a commonhold association may be able to cover the cost by making an emergency request for a contribution to shared costs. The 2002 Act is silent on emergency requests, but the commonhold community statement ("CCS") provides that, in an emergency, it is possible for the commonhold association to require a contribution to shared costs from the unit owners, without the need for prior consultation. Although we propose in Chapter 10 at paragraph 10.32 that contributions to shared costs should normally require the approval of the unit owners, we are not proposing any changes to the principle that, in an emergency, a request for a contribution to shared costs can be made without consultation, and without the prior approval of unit owners. If this power to demand emergency contributions is misused, then the directors run the risk that unit owners who object will refuse to pay, taking the point that the request was not validly made on an emergency basis. The possibility of unit owners taking this point should discourage misuse of the procedure by directors; and the risk of having to pay legal costs should deter unit owners from objecting to emergency claims which have been properly made.

11.9 There will, however, be occasions when it is not practicable to make an emergency request for a contribution to shared costs which will cover the urgent expenses. In particular, the expenses involved may be sufficiently large that it is apparent that a substantial number of unit owners will not be able to meet the request. Even if only a few cannot meet the demand, it may cause resentment on the part of those who have struggled to pay it.

11.10 In some situations it may be possible to meet the urgent expenditure by using a reserve fund which has been built up for another purpose. We have discussed the use of reserve funds in Chapter 10 at paragraphs 10.68 and 10.69.

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3 Commonhold Regulations 2004, sch 3 para 4.2.5. The expression "emergency assessment" is not used in the CLRA 2002, but is used in sch 3 at 4.2.5 and in Form 3, the special form which must be used.
11.11 In other situations, however, it may be impossible for the commonhold association to meet urgent expenditure either by a request for an emergency contribution to shared costs, or by resorting to its reserves. In such cases the association has two options: to sell off part of the common parts, or to borrow the money.

11.12 With many commonholds, there will be no scope to sell off any of the common parts. Sometimes, however, it may be possible to do so. There may be garden land, or a landscaped area, which has development potential. It is possible that the roof and airspace over a building may have a development value which could be realised. It is also possible that leisure facilities – such as a swimming pool or fitness suite – could be sold off.

11.13 In order to sell a portion of the common parts, the commonhold association would have to comply with various requirements. The CCS cannot prevent, or restrict, the sale of any of the common parts. Selling off part would, arguably, always involve an alteration of the common parts, if so, then it would require the support of an ordinary resolution of the members. This assumption is made in the Commonhold (Land Registration) Rules 2004, which requires that a sale of part of the common parts must be accompanied by an application to register an amended CCS. The amendment of the CCS would also require an ordinary resolution. If an entrenched provision required amendment, a higher threshold of support might be required.

11.14 The commonhold association has capacity to borrow by virtue of the broad objects clause contained in its articles of association. The 2002 Act expressly recognises that the commonhold association can borrow money. The Act provides that the association may create a legal charge over the common parts provided that the unanimous consent of the unit owners is obtained by a resolution passed before the charge is created. Although the 2002 Act does not specify the extent of the charge, it was assumed that the common parts would be registered under a single title number, which is indicative of any charge being over the whole of the common parts. A charge over the common parts can be described as a “fixed charge” as it is granted over an identified (“fixed”) extent of land.

11.15 A legal charge over the common parts will often not provide an attractive, or even an acceptable, security to lenders. The common parts of buildings which include flats - exterior walls and structure, and the staircases and landings - will not be separately saleable. In some blocks there may, however, be garden land, airspace, or leisure facilities which could be sold separately – as described at paragraph 11.12 above.

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4 CLRA 2002, s 27(1)(a).
5 Commonhold Regulations 2004, sch 3 para 4.6.1. An ordinary resolution requires either over 50% of the votes cast to be cast in favour if the vote is taken at a meeting, or over 50% of all votes in the commonhold to be cast in favour if the written resolution procedure is used.
6 Commonhold (Land Registration) Rules 2004, r 16.
7 Commonhold Amendment Regulations, sch, art 4.
8 CLRA 2002, s 29.
9 See further para 11.39(2) below.
11.16 In principle, a lender would be able to exercise its power of sale, and to sell such parts of the building. It would, however, be necessary to restrict, or remove, any rights over them which the CCS has granted. If the commonhold association is selling voluntarily, as described in paragraph 11.13 above, then the general meeting of the unit owners which approved the sale would, at the same time, have to approve the necessary amendments to the CCS. Where a commonhold association is insolvent, the court might, as a condition of granting a succession order, require the sale of part of the common parts (see Chapter 7, paragraph 7.60). If it did so, the court would also impose a condition requiring that the CCS be amended. But where a lender is attempting to sell part of the land comprised within its security, there would not appear to be any equivalent mechanism which it could use to force the issue, and require the CCS to be amended.

11.17 Where there is no particular asset that can be used as security for a loan, a commonhold association may be able to borrow money on a secured basis by creating a floating charge. A floating charge is so-called because it is not attached to any particular land or assets.

11.18 With a floating charge, the borrowing takes the form of a mortgage or charge over all the assets which the commonhold association owns at any time, and repayments (of capital and interest) are made from the commonhold contributions. In effect, it is a way of enabling it to borrow against, what is sometimes called, its “income stream” – the right to require unit owners to contribute to the shared costs.

11.19 The ability of a commonhold association to grant a floating charge is not expressly addressed by the 2002 Act. It may have been overlooked that a commonhold association, like any other company, would be able to grant a floating charge. Alternatively, it may have been assumed that a commonhold association would create a floating charge only when combined with a mortgage of the common parts which, as explained in paragraph 11.14 above, can be granted only with unanimous consent. As a matter of general company law, however, it is possible for a commonhold association to grant a floating charge over its undertaking without also granting at the same time a charge over its fixed assets. There is no reason, under the current law, why a commonhold association should not have this power.

11.20 When a company grants a floating charge, the charge generally “floats” over all the assets of the company, and the company may continue freely to deal with them. However, if the company defaults on its debts, the charge then crystallises or “bites” and everything that it owns at that point becomes subject to the security.

11.21 Once the floating charge has crystallised, the lender has the power to appoint an administrator, who would take charge of the running of the commonhold association. He or she would assume the powers of the association – both the directors and the members – and would therefore be able to set commonhold contributions to ensure that the loan repayments were made. Although the appointment of an administrator would mark a considerable loss of autonomy on the part of the unit owners, it would continue

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10 See ch 7, para 7.18.
only until the loan was repaid. When it was repaid, the owners would be able to continue to run their commonhold exactly as before.

CRITICISMS OF THE CURRENT LAW

11.22 The key issues with the current law are twofold. First, as noted at paragraph 11.14 above, under the 2002 Act a commonhold association needs a unanimous resolution of the unit owners before it can grant a legal charge over its common parts. The requirement of unanimous consent may make it practically difficult for the commonhold association to exercise its powers to grant a fixed charge over the common parts. The requirement would seem to be based on the principle that the unit owners will have purchased their units in the expectation that they will have the use of the common parts, and the granting of a charge could have the result that certain parts are sold against their wishes. Common parts becoming subject to a charge would also have implications for mortgage lenders secured against units, which would have lent on the basis that the unit enjoyed the use of these facilities. Indeed, in practice, unit owners may need the consent of their own mortgage lender before supporting the grant of a charge by the commonhold association. Given that the funding is being sought in situations of emergency, it may be expected that granting consent will ultimately be in the interests of the lenders, though we consider this point further below.

11.23 Second, as noted at paragraph 11.19 above, because the 2002 Act does not make specific provision for the creation of a floating charge, there would appear to be nothing to prevent the directors from granting a floating charge over the undertaking without obtaining any consents at all. This position seems anomalous, given that a unanimous resolution of the unit owners is required before a legal charge is granted over the common parts. A floating charge is likely to be more attractive to the lender than a legal charge over the common parts. It is also undesirable to allow the directors to grant a charge without consent that could result in the members no longer having control of the commonhold.

PROPOSALS FOR REFORM

11.24 We do not think that the grant of a fixed or floating charge by a commonhold association will be a common occurrence. Commonhold associations will be able to manage most expenditure adequately through the commonhold contributions. Even in the case of an emergency, expenditure may be met through requesting an emergency contribution from the unit owners, or by recourse to reserve funds.

11.25 Notwithstanding, we think it is important that adequate provision is made for the grant of fixed or floating charges so that these forms of finance may effectively be accessed to deal with exceptional unforeseen expenditure.

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12 A unanimous resolution requires either 100% of the votes cast to be cast in favour if the vote is taken at a meeting, or 100% of all votes in the commonhold to be cast in favour if the written resolution procedure is used.

13 It is difficult to envisage circumstances in which a lender would exercise its power of sale over the whole of the common parts.

14 It seems likely that any such floating charge would then crystallise over all the assets of the commonhold association except the common parts, as the charge would then have been created without complying with CLRA 2002, s 29.
Lenders’ consent to a fixed or floating charge

11.26 As noted in paragraph 1.22 above, unit owners may need the consent of their mortgage lender before agreeing to a fixed or floating charge being granted by the commonhold association. A unit owner who votes in favour of the charge without his or her own lender’s consent may be in breach of his or her mortgage contract. We are concerned that the need for consent may mean that mortgage lenders block the ability of a commonhold to obtain emergency funding by withholding consent. We are not sure whether this concern is a significant one. Obtaining emergency funding may be in the interests of mortgage lenders to protect their security. However, we would like to hear consultees’ views.

11.27 If there is a significant risk of emergency finance being blocked by mortgage lenders withholding consent, then we would wish to put protection in place. For example, it might be appropriate to enable the First-tier Tribunal (Property Chamber) and the Residential Property Tribunal Wales (together referred to as “the Tribunal”) to override a mortgage lender’s refusal of consent where it takes view that the interests of the commonhold in obtaining finance override the interests of an individual lender or lenders.

Consultation Question 62.

11.28 We invite consultees’ views as to whether the need for unit owners to obtain the consent of their mortgage lender to support the commonhold association granting a fixed or floating charge is likely to be a significant difficulty in raising emergency funding.

11.29 If consultees consider that there might be difficulties, we invite views on what measures could be put in place to alleviate these difficulties, including whether the Tribunal should be able to override a mortgage lender’s refusal to give consent.

Making express provision for a floating charge

11.30 We are provisionally of the view that commonhold associations should be given explicit power to raise money through a floating charge. Doing so ensures that the circumstances in which a floating charge can be granted are properly provided for and removes the current anomalous position between floating and fixed charges. In particular, it enables provision to be made for the level of consent that is required before a floating charge is granted. We consider what level of consent should be required below.

The level of consent required to grant a fixed or floating charge

11.31 As we have noted, unanimous consent is currently required for a charge to be granted over the common parts. Two questions arise: first, whether the level of consent required should be the same for a charge over the common parts and a floating charge; and secondly what the level of consent should be.

11.32 A good case can be made for saying that creating a floating charge over the undertaking of the commonhold association should require the same level of support as would be required for the creation of a fixed charge over the common parts. The two situations are not, however, entirely the same. In neither case need the charge have any effect if
the association keeps to the terms of its borrowing agreement. In the case of a fixed charge, if the lender should sell part of the common parts, then they are permanently lost to the commonhold. With a floating charge, on the other hand, if the payments under the loan agreement are not kept up, then the unit owners will lose control of their association until the loan is repaid, but ultimately they can be returned to the status quo before the floating charge was created.

11.33 Notwithstanding these differences, the two may often be created by the same document, and it seems a recipe for confusion if the two require different thresholds of support. Therefore, we are provisionally of the view that the same threshold should apply.

11.34 In determining the threshold that should be required, we have taken into account a number of factors. First, the need to protect unit owners on whom the costs of the charge will fall. Secondly, the practical difficulties of obtaining unanimous consent. Thirdly, that the granting of any charge by the commonhold association should only be resorted to as an exceptional measure. Finally, that when a charge is sought, the circumstances of the emergency may be such that an inability to raise funds may result in the insolvency of the commonhold association.

11.35 With these factors in mind, we do not think that unanimous consent should be required; such a threshold may result in one unit owner determining the fate of the commonhold. If a lender puts in a receiver under a charge, it would result in the commonhold losing its ability to govern itself, until the debt was repaid. We therefore provisionally propose that in the absence of unanimous consent, a high threshold should still be required. This could be set at the same threshold as termination, 80% of the available votes of the unit owners. In addition, the decision, if not unanimous, should be subject to the oversight of an independent body. We think that oversight should be provided by the Tribunal. The Tribunal would have to be satisfied that the creation of the charge was either the most appropriate way for the commonhold association to fund works which were necessary, or that it was the most appropriate way for the association to avoid possible insolvency.

**Consultation Question 63.**

11.36 We provisionally propose that express provision should be made for a commonhold association to grant a floating charge.

Do consultees agree?

11.37 We provisionally propose that a charge over the common parts or a floating charge should only be able to be granted when either:

(1) The unit owners unanimously consent to the charge: or

(2) 80% of the unit owners consent to the charge, and approval is obtained from the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal Wales.

Do consultees agree?
Making the fixed charge more practicable – charging only part of the common parts

11.38 Consideration of the practicalities of the commonhold association charging its common parts has prompted us to consider a subsidiary issue. It has been suggested at paragraph 11.15 above that the common parts will not generally appear to be an attractive security to lenders. The exterior walls and internal common parts are obviously not saleable on their own, and it may not be clear how those common parts which might be sold could be separated out. The uncertainty over which of the common parts a lender might attempt to sell could be problematic for unit owners. Security over a predetermined part of the common parts – undeveloped garden land; the attic, or the airspace over the roof; or leisure facilities which might be sold off and operated independently – might be more attractive to both lenders and unit owners. The lender would know the values and what was being offered for security, and members of the association would know in advance what part of their common facilities they were putting at risk. If this is likely to be what will happen in practice, it might be better for the legal charge to be expressly limited in this way. We therefore think that it should be clarified that the commonhold association has express power\(^{15}\) to charge part only of the common parts.

11.39 If the idea of a “fixed charge of part” is to become more practicable, then some consequential points need to be addressed:

1. in practice, if a registered proprietor created a charge over part of the land in a registered title, the registrar is likely to create a separate title for the charged part;\(^ {16}\) and

2. while it seems that the creation of a separate title to part of the common parts would be permissible under the current law, the general assumption\(^ {17}\) has been that the common parts would normally be registered under a single title number.\(^ {18}\) If necessary express provision could be made in the Land Registration Rules to permit the title to the common parts to be “split” if part were charged.

\(^{15}\) This would appear to be possible under the current law: CLRA 2002, s 29. It is perhaps obscured by the assumption, referred to at 11.39(2) below, that the common parts will be registered under a single title number.

\(^{16}\) Land Registration Rules 2003, SI 2003 No 1417, r 3(3)(c). Texts such as Megarry and Wade: The Law of Real Property (8th ed 2012) and Ruoff & Roper: Registered Conveyancing (loose-leaf ed 2018) do not seem specifically to address the issue.

\(^{17}\) This would appear to be the assumption underlying HM Land Registry, Practice Guide 60: Commonhold (July 2018), para 4.1.

\(^{18}\) The special provisions in the Commonhold (Land Registration) Rules 2004, r 3(2) and 3(3) are designed to ensure that if, for example, a registered proprietor owns more than one unit – even adjacent units – the registrar does not amalgamate the titles and so confuse the structure of the commonhold. The Commonhold (Land Registration) Rules (r 3(2)) disapply certain provisions of the Land Registration Rules, SI 2003 No 2114 but do not disapply s 3(3)(c), which, as noted, would permit the registrar to create a new title for the part which was subject to the legal charge.
Consultation Question 64.

11.40 We provisionally propose that it should be possible for a commonhold association (having obtained the requisite consent) to grant a charge over part of the common parts. Where such a charge is granted, the part of the common parts so charged may be registered with a separate title number.

Do consultees agree?
Chapter 12: The ban on residential leases – possible exceptions

INTRODUCTION

12.1 Currently the grant of residential leases for more than seven years is prohibited within commonhold. As commonhold was designed to overcome the shortcomings in residential leasehold ownership, it was considered inappropriate to allow residential leasehold to continue within commonhold.

12.2 However, responses to our Call for Evidence highlighted that the ban on residential leasehold may have some undesirable consequences. In particular, it prevents some arrangements which rely on longer residential leases, such as shared ownership leases and lease-based home purchase plans. We explain these arrangements in more detail in this chapter. In brief, shared ownership, commonly known as “part buy, part rent” is a prevalent form of Government-funded affordable homeownership, while lease-based home purchase plans offer a way of funding homeownership in a way which is compliant with Islamic beliefs.

12.3 In this chapter we explore whether exceptions should be made to the general ban on residential leases in commonhold and how leases could be accommodated, should exceptions be necessary.

THE CURRENT LAW

12.4 The Commonhold Regulations prohibit unit owners from granting residential leases for a term of longer than seven years; non-residential leases of any length may, however, be granted. There is one limited exception to this restriction on residential leases which applies where a building has been converted to commonhold. On conversion to commonhold, all leases, of any length, will be extinguished. However, it is possible to regrant leases of up to 21 years to those leaseholders whose interests have been terminated on conversion, provided these leases are regranted on “equivalent terms”.

12.5 Any leases granted, of seven years or less, must not be granted for a premium (which is a one off initial payment payable at the point of sale, in addition to any rent due under the lease). The prohibition on payment of a premium ensures that short leases are used only to enable a unit to be rented by a tenant with no financial stake in the unit.

12.6 The reason behind the ban on residential leases of over seven years, as confirmed in the explanatory notes to the 2002 Act, was to “avoid the possibility of repeating the difficulties which exist in leasehold blocks”. Commonhold was designed to remove

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20 Commonhold Regulations 2004, reg 11(2). We provisionally propose at para 3.152 of ch 3 that leases of less than 21 years should instead continue automatically following conversion to commonhold.
21 Explanatory Notes to CLRA 2002, s 17, para 65.
problems associated with leasehold, such as the fact leases lose value over time, and to create a new structure for managing the relationship between owners of flats in the building.

12.7 Other concerns include that the unit owner should be the party with the substantial interest in the commonhold with responsibility for paying the commonhold contributions. If the leaseholder were to take over the payment of contributions and have a say in the management of the commonhold association, this would create a relationship akin to that of freeholder and leaseholder; the relationship commonhold is designed to remove. Allowing leasehold would run contrary to “one of the central purposes of the commonhold scheme… to abolish the third-party ground landlord who has limited direct continuing interest in the day-to-day management of the property.”

12.8 Additionally, there is an argument for simplicity. Prohibiting the grant of leases within commonhold avoids the need to adapt the statutory rights and protections available to leaseholders (such as those relating to the payment of service charges and enfranchisement rights) to fit the commonhold model.

12.9 The period of seven years was chosen as it reflects the landlord’s statutory repairing obligations in respect of residential leases granted for less than seven years. In particular, a landlord who has granted a lease of less than seven years has a statutory duty to keep the structure and exterior of the building in repair. This obligation cannot be contracted out of. Limiting leases to those of less than seven years therefore ensures that the unit owner remains the party responsible, and interested in, the management and maintenance of the building.

12.10 The seven-year limit also tied in to reforms to land registration introduced in the same year that the 2002 Act was passed. The reforms to land registration required leases of more than seven years to be registered.

CRITICISMS OF THE CURRENT LAW AND PROPOSALS FOR REFORM

12.11 We acknowledge the concerns, discussed above, which have led to the ban on residential leases within commonhold. In particular, we recognise the weight of the arguments against perpetuating the leasehold problem within commonhold. However,

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22 Commonhold and Leasehold Reform: Draft Bill and Consultation Paper (August 2000) Cm 4843, p 86 noted there should be "no long-term occupants… whose interest differs from that of a unit holder"; Commonhold: A consultation paper (1990) Cm 1345, para 4.55 says it is a "fundamental concept of commonhold… that the commonhold should be democratically run by and for the benefit of the unit holders".


24 See further ch 2 and ch 4 for further discussion on these rights.


26 See, for instance, Hansard (HL), 13 November 2001, vol 628, col 463 where Baroness Scotland says the seven year period was “chosen because it is the time limit at which responsibility for repair and insurance to the property passes from the landlord to the tenant.”

27 Landlord and Tenant Act 1985, s 11 to s 14.

28 Land Registration Act 2002.
we also want to ensure that commonhold can have as wide an application as possible. The responses to our Call for Evidence indicate that exceptions may be necessary to ensure commonhold is successful.

12.12 We have identified two specific areas where it may be necessary to consider exceptions: affordable housing (and in particular shared ownership leases); and home purchase plans, which rely on the grant of leases over seven years.

12.13 These exceptions have been raised previously. Respondents to the 2003 consultation, that preceded the introduction of the Commonhold Regulations, advocated exceptions for shared ownership leases granted by social landlords and lease-based home purchase plans. In response to these concerns, the Department for Constitutional Affairs announced its intention to deal with issues such as shared ownership and Islamic financing in follow up measures in 2005. It was expected that exceptions to the ban on leases would be made through further regulations, however, these regulations did not materialise.

12.14 We discuss each of these areas of concern and make provisional proposals for reform below.

**Affordable housing**

12.15 We have identified two types of affordable housing where the ban on residential leasehold within commonhold could create difficulties; firstly, shared ownership and secondly, community land trusts and housing co-operatives. However, whilst we discuss both types of affordable housing below, we provisionally propose that an exception is only needed for the former.

**Shared ownership**

12.16 Shared ownership plays a key role in governments’ strategies to provide more affordable homes in England and Wales. Government has allocated funds to deliver 135,000 more shared ownership homes in England before 2021 and the Welsh Government has a target to build 20,000 new affordable homes over the course of this Assembly. Additionally, local authorities, through planning law, require developers to allocate a certain percentage of units in new developments to affordable housing, such as shared ownership.

12.17 Our Terms of Reference with Government require us to consider ways of incorporating shared ownership leases within commonhold. Shared ownership enables a person to

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30 DCA “Delivering justice, rights and democracy: DCA Departmental Report 2004/05”.
buy a percentage share in the ownership of a house or a flat (between 25% and 75%) and pay a rent on the remaining share owned by the landlord. The rent is reduced to reflect the amount purchased. A person can then buy additional shares until he or she has bought 100% of the property. The purchase of these additional shares is known as staircasing.

12.18 Once a shared ownership leaseholder (referred to as a “shared owner”) has staircased to 100% ownership of the property, his or her rights are enhanced. In the case of a house, the lease normally provides that he or she is able to apply for the freehold of the house. If it is a flat, the shared owner will remain a leaseholder, although certain terms of the lease, which related to shared ownership, will no longer apply.

12.19 Shared ownership, of both houses and flats, is currently enabled by the grant of a lease, usually for a term of 99 years for a house or 125 years for a flat. Since residential leases of this length are prohibited in commonhold, it is not possible for a shared ownership lease to be accommodated within commonhold.

12.20 Homes England and the Welsh Government offer grant funding for the provision of shared ownership leases as part of their respective Help to Buy schemes. In England, shared ownership leases are generally granted by registered providers, which are landlords registered with the Regulator of Social Housing and include housing associations. However, it is also possible for bodies which are not so registered to grant shared ownership leases and to obtain funding. In Wales, grant funded shared ownership leases are offered by participating landlords registered with the Welsh Government. We refer to organisations which grant shared ownership leases as “Providers”.

12.21 In order to be eligible for grant funding in England, the shared ownership lease must contain certain fundamental clauses. These clauses are set out in a model shared ownership lease produced by Homes England. We understand that the inclusion of certain clauses is also one of the criteria for obtaining funding in Wales.

34 There are some limited exceptions to the ability to staircase to 100% ownership. These include some shared ownership arrangements for rural areas and some arrangements providing shared ownership accommodation for older people. It is also acknowledged that a significant proportion of shared ownership leaseholders may be unable to afford to staircase or, for various reasons, may choose not to do so. See further D Cowan, A Wallace and H Carr, Exploring Experiences of Shared Ownership Housing: Reconciling Owning and Renting (Bristol: University of Bristol Law School 2015) p 10.

35 Homes and Communities Agency, “Shared Ownership: Joint guidance for England” (October 2016) para 5. Shared ownership leases are excluded from statutory provisions, such as those under the Leasehold Reform and Urban Development Act 1993, for extending a long lease (known as enfranchisement and subject of a separate Law Commission project). Therefore, in order to have a realisable and mortgageable value the lease will need to be granted for a long term (see Richmond Housing Partnership Ltd v Brick Farm Management Ltd [2005] EWHC 1650 (QB), [2005] 1 WLR 3934, p 3939 by Stanley Burnton J).

36 The Regulator of Social Housing takes over this function from the Homes and Communities Agency.

12.22 The inability to grant shared ownership leases in commonhold has been described as “a major obstacle to the market acceptance of commonhold”. This view was shared by several respondents to our Call for Evidence. Trowers & Hamlinis LLP, for example, said that “the statutory restrictions on leasing residential commonhold units rule out shared ownership leases with the result that commonhold could not work for a significant number of new developments.”

12.23 Particular concerns were raised over the ability to meet planning obligations for the provision of affordable housing without the ability to grant shared ownership leases. Some respondents to our Call for Evidence also noted that shared ownership has become more prevalent since commonhold was introduced, increasing the importance of accommodating it within commonhold.

12.24 On the other hand, some respondents argued that the shared ownership model could be achieved in other ways, without the grant of a lease. Co-ownership arrangements were suggested as a possible way to achieve shared ownership without the need for a lease. At its most basic, co-ownership is simply the ownership of something by more than one person (which may be an individual or an organisation).

12.25 A co-ownership trust could be created under which the provider and shared owner co-own the property under the trust. They will each own a specific share of the property which will be determined by the amount of money the shared owner has invested in the property. For example, if the shared owner has paid 25% towards the value of the property, the shared owner would own a share of 25% of the property and the Provider would own the remaining 75%. The shared owner would then be able to pay the rest of the property value in stages. In the meantime, the shared owner would be required to pay rent on the percentage of the property still owned by the Provider. These provisions, and the other terms of their relationship, would be set out in a trust deed. Once the shared owner had bought 100% of the property the trust could be brought to an end, leaving the shared owner as the sole owner.

12.26 HM Revenue and Customs has published guidance on co-ownership trusts and expressly notes that they have been developed as a way of providing affordable housing in commonhold. Lenders, such as Nationwide, have previously been reported to be willing to lend on these arrangements, although it has been noted that Government funding systems for shared ownership would need to be revised to accommodate co-ownership based arrangements.

12.27 Some respondents to our Call for Evidence advocated relying on other schemes of affordable housing which do not rely on leasehold, and especially the shared equity model, as an alternative to shared ownership leasehold. This scheme is discussed at paragraph 12.65 below.

39 A law firm.
40 See Commonhold: A Call for Evidence – Analysis of Responses paras 5.28 to 5.29.
12.28 Whilst it may be possible, in time, to move to alternative forms of shared ownership provision, such as co-ownership trusts, our Terms of Reference with Government require us to accommodate shared ownership in its present form. Currently the only form of shared ownership which Homes England and the Welsh Government provide funding for is the leasehold model.

12.29 We therefore provisionally propose that a limited exception to the ban on residential leases over seven years in commonhold be permitted for shared ownership leases which contain the fundamental clauses prescribed by Homes England or the Welsh Government. These clauses provide a certain level of protection for leaseholders, such as standardised rent review provisions. The clauses also provide protection for mortgage lenders who finance shared ownership purchases. Making an exception for shared ownership leases should therefore not see the same abuses which have been witnessed elsewhere in residential leasehold, which are discussed in Chapter 1, paragraphs 1.62 to 1.63.

**Consultation Question 65.**

12.30 We provisionally propose making an exception to the prohibition on residential leases over seven years, and leases granted at a premium, for shared ownership leases which contain the fundamental clauses prescribed by Homes England in England or the Welsh Government in Wales.

Do consultees agree?

Operation of shared ownership leases in commonhold

12.31 We propose that the Provider should always be the registered owner of the commonhold units it leases to shared owners.

12.32 The relationship between the shared owner and Provider is therefore preserved and the staircasing provisions of the lease remain intact. The shared owner will buy additional shares of the property, through the staircasing provisions of the lease, and will obtain enhanced rights on 100% ownership. With regards to other aspects of how the shared ownership relationship will operate in commonhold (for example, who can vote on commonhold decisions and what happens on final staircasing), the position may vary depending on whether the commonhold is a new development or has been converted from leasehold.

12.33 We first set out our provisional proposals for new commonhold developments, before considering whether the same position can be achieved on conversion to commonhold.
New commonhold developments

Rights and responsibilities of the shared ownership leaseholder

12.34 Although shared owners do not initially own the property outright, the expectation is that they will take on “the usual responsibilities of a full owner-occupier, such as sole responsibility for repairs and maintenance of the property”. Applying this policy consideration to commonhold, we think shared owners should “buy into” the commonhold model and take on the rights and responsibilities of a commonhold unit owner on purchasing the lease.

12.35 We provisionally propose that a new model shared ownership lease should be produced for commonhold units. The terms of this lease should require the shared owner to comply with the commonhold community statement (“CCS”). A copy of the CCS could therefore be annexed to the shared ownership lease.

12.36 Under our provisional proposals, the Provider, as unit owner, would remain ultimately responsible to the commonhold association for ensuring that the terms of the CCS are complied with. However, if the shared owner fails to comply with the CCS, this would constitute a failure to comply with the shared ownership lease. The Provider would be able to bring a claim against the shared owner for breaching the terms of the lease and for any loss caused. For instance, the Provider could apply for a court order requiring the shared owner to comply with the CCS (“an injunction”) or in appropriate circumstances, take action to terminate the lease.

12.37 In return for assuming the responsibilities set out in the CCS, we provisionally propose that the unit owner’s voting rights should be delegated to the shared owner in the model lease. For example, shared owners should be able to exercise the vote on decisions to:

- (1) appoint and remove directors;
- (2) approve the draft costs budget for the following year (see paragraphs 12.39 to 12.41 below);
- (3) make alterations to the common parts;
- (4) grant a charge over the common parts;
- (5) add, remove or amend local rules of the CCS; and
- (6) terminate the commonhold (see paragraph 12.38 below).

Two of these decisions raise particular issues and are considered further below.

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43 This is the stated position in the government’s guidance on shared ownership for England: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/557219/Shared_Ownership_-_Joint_Guidance.pdf, para 5. The expectation that shared owners will take on these responsibilities is reflected in the terms of the model shared ownership leases issued by Homes England. In particular, shared owners are required to keep their property “in good and substantial repair and condition” and, where the property is a flat, to reimburse the landlord for all costs reasonably incurred “in connection with the repair, management, maintenance and provision of services for the building”: Model shared ownership flat lease, para 3.4 and model shared ownership house lease, para 3.5.
Termination of the commonhold

12.38 Currently, it is possible for a commonhold to be brought to an end with the agreement of at least 80% of the unit owners. A decision to terminate the commonhold will result not only in the commonhold association being wound-up, but also the sale of individual units. Given the significance of the decision to terminate and the fact Providers will be unit owners with a financial interest in the unit, we think Providers should be able to exercise the decision to terminate jointly with the shared owner. This joint vote will mean that the vote will only be counted in favour of termination if both the Provider and shared owner agree. If either the Provider or shared owner do not support the voluntary termination, then the vote would be cast negatively in respect of that unit.

Approving the commonhold budget

12.39 In Chapter 10 we provisionally propose that the budget of commonhold costs, set by the association’s directors each year, should be approved by a decision of more than 50% of the unit owners. Additionally, in Chapter 10, we propose introducing certain new rights to challenge commonhold costs before they have been incurred. Where the unit is subject to a shared ownership lease, we provisionally propose that these rights should be exercisable by the shared owner, rather than the Provider. We consider this position to be fair, given that the shared owner will ultimately bear the costs associated with that unit.

12.40 We also provisionally propose that the above rights within commonhold will replace any existing statutory rights associated with being a residential leaseholder.\(^{44}\) In particular, they would replace the right to challenge the reasonableness of service charge costs demanded by a landlord after the costs have been incurred.\(^ {45}\) Additionally, the rights available in commonhold would replace leaseholders’ statutory right to be consulted before a landlord incurs costs for works, or enters into contracts above a certain value (referred to as “section 20 consultation”).\(^ {46}\)

12.41 In commonhold, unit owners will not be able to challenge commonhold costs after they have been incurred. We propose to maintain this feature of commonhold to help preserve the solvency of the commonhold association see further Chapter 10. If shared owners were to retain their statutory right to challenge costs after they have been incurred, it would place the Provider in the position of being required to pay costs to the commonhold association which may then not be recoverable from the shared owner.

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\(^{44}\) These rights are set out predominantly in the Landlord and Tenant Act 1985, ss 18 to 30.

\(^{45}\) Landlord and Tenant Act 1985, ss 19 and 27A. “Service charge costs” are those which relate to the landlord (or superior landlord’s) costs of repairing, maintaining, improving, insuring and managing the building and for providing services. To benefit from this statutory protection, the service charge payable must reflect the landlord’s actual costs of providing the services, rather than being a fixed amount in the lease.

\(^{46}\) The right to be consulted arises where the cost of the works, or costs to be incurred under the contract, exceed a prescribed rate per leaseholder. This rate is currently £250 for qualifying works and £100 per annum in respect of qualifying contracts: The Service Charges (Consultation Requirements) (England) Regulations 2003, SI 2003 No 1987 regs 4 and 5. There is a statutory procedure landlords must follow when consulting with leaseholders, referred to as “section 20 consultation” (as it is provided for under section 20 of the Landlord and Tenant Act 1985). If the landlord fails to follow this statutory procedure, the amount which may be recovered from the leaseholders will be capped to either £250 or £100 per leaseholder respectively.
Protections for Providers

12.42 In addition to the Provider’s right to vote on a decision to terminate the commonhold, certain commonhold decisions will always require the consent of the unit owner.\textsuperscript{47} We provisionally propose that both the Provider and the shared owner’s written consent should be required to:

1. change the rights which may be exercised over a commonhold unit;
2. change the permitted use of the commonhold unit;
3. change the boundaries of the commonhold unit; and
4. remove the unit owner’s right to use particular areas of the commonhold.

Interest acquired on final staircasing

12.43 On purchasing 100% of the value of the property, we provisionally propose that, in new commonhold developments, the shared owner should become the registered owner of the commonhold unit and should become a member of the commonhold association. Staircasing would therefore operate in the same way as staircasing to 100% ownership of an individual freehold house (see paragraph 12.19 above).

Consultation Question 66.

12.44 We provisionally propose that in new commonhold developments, the model shared ownership lease should require the shared ownership leaseholder to comply with all terms of the CCS.

Do consultees agree?

12.45 We provisionally propose that shared ownership leaseholders in new commonhold developments should be able to exercise all the votes of the commonhold association in place of the shared ownership provider, apart from a decision to terminate, which should be exercised jointly with the provider.

Do consultees agree?

12.46 We provisionally propose that shared ownership leaseholders in new commonhold developments should not have the same statutory rights as other leaseholders to challenge service charge costs or to be consulted on works and contracts exceeding a certain amount.

Do consultees agree?

12.47 We provisionally propose that, in new commonhold developments, on purchasing 100% of the value of the commonhold unit, the shared ownership leaseholder should be transferred the commonhold title of the unit and should become a member of the commonhold association.

Do consultees agree?

\textsuperscript{47} Commonhold Regulations 2004, sch 3 para 4.8.
Conversion to commonhold

12.48 We now consider the position where a shared ownership lease is already in place at the time an existing building is converted from leasehold to commonhold. Conversion is discussed in detail in Chapters 2 to 4. In Chapter 3, we present two possible outcomes which may apply following conversion to commonhold. Which outcome is pursued will depend on consultee’s views in response to this chapter. Depending on which outcome is pursued, following conversion the Provider will either own a leasehold interest superior to that of the shared owner or become a unit owner. Importantly, however, in either scenario, the shared ownership relationship and staircasing provisions will remain intact. However, the following two questions arise should the Provider become a unit owner on conversion.

(1) **Should the Provider, as unit owner, be able or required to delegate voting rights to the shared owner?** We provisionally propose above, that in new commonhold developments, the shared ownership lease should delegate the right to vote on commonhold decisions to the shared owner. It would, however, be difficult to replicate the same position on conversion of an existing building to commonhold. It would mean altering the terms of the shared ownership lease retrospectively. We therefore propose that, whilst it should be possible for Providers and shared owners to agree for certain rights to be delegated on a voluntary basis, this delegation should not be mandatory.

(2) **Should the unit owner acquire the commonhold unit on staircasing to 100%?** At present, the model shared ownership lease for flats provides that, on staircasing to 100%, certain provisions of the lease cease to apply, although the lease itself continues. It may be possible to argue that, instead of remaining on a lease, the shared owner should become the registered owner of the commonhold unit on final staircasing. However, again, this would require the terms of the model shared ownership lease to be varied retrospectively. It would change the interest that the shared owner stands to acquire, and it is likely that a commonhold unit will be more expensive than a leasehold flat. We think a preferable approach would be to maintain the current position on final staircasing. The shared owner would remain a leaseholder and the provisions of the lease specific to shared ownership would fall away. However, we provisionally propose that the shared owner should be provided with a statutory right to purchase the commonhold unit on final staircasing.

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This situation may arise if long leaseholders who do not want to convert to commonhold are able to retain their leases following conversion, see conversion Option 1 discussed in ch 3. Where the Provider has a lease which is superior to that of the shared owner on conversion (for example, the freeholder may have granted a long lease to the Provider which the Provider then sub-lets to one or more shared owners), under Option 1, the Provider would be able to choose whether to take a commonhold unit or remain on its existing lease. Alternatively, if the Provider were the freeholder of the building before conversion, under our proposals for Option 1, the Provider would be granted new 999-year leases of any flats let to shared owners, see ch 3.

This situation may arise where the Provider has a lease which is superior to that of the shared owner before conversion and elects (under conversion Option 1) or is required (under conversion Option 2, see further ch 3) to take a commonhold unit. Under conversion Option 2, no long leases (other than the exceptions discussed in this chapter) will be allowed to continue. Under conversion Option 2, where the Provider is the freeholder of the building before conversion to commonhold, we propose that the Provider should be entitled to become the unit owner of any units let to shared ownership leaseholders.
(either immediately on staircasing to 100%, or later) if he or she wishes to do so. This right would replicate the statutory right of leaseholders of houses to purchase the freehold of their homes.\textsuperscript{50}

\begin{center}
\textbf{Consultation Question 67.}
\end{center}

\begin{itemize}
\item 12.49 We provisionally propose that in a building which has converted to commonhold, the shared ownership provider should have voting rights in the commonhold association. Delegation of voting rights to the shared owner will be possible on a voluntary basis, but not mandatory.
\item 12.50 We provisionally propose that, in a building which has converted to commonhold, the staircasing provisions of any existing shared ownership leases should continue to operate in the same way. On staircasing to 100%, the shared owner will therefore remain a leaseholder.
\item 12.51 We provisionally propose that after having staircased to 100% of the value of the leasehold flat, the shared ownership leaseholder should have a statutory right to purchase the commonhold unit and become a member of the commonhold association.
\end{itemize}

Community land trusts and co-operatives

12.52 Community land trusts are defined as organisations set up to further the social, economic and environmental interests of a local community by acquiring and managing land and other assets and ensuring that those assets are not sold or developed, except to benefit the local community.\textsuperscript{51} Any profits from their activities must be used to benefit the local community (although not through direct payment to their members). Individuals who live or work in the area must be able to become members of the trust. In practice, a community land trust will develop its own land and make properties available at an affordable rate.\textsuperscript{52}

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\textsuperscript{50} The right of leaseholders of houses to purchase the freehold of their homes, is provided for in the Leasehold Reform Act 1967 and is being considered as part of the Law Commission’s separate project on leasehold enfranchisement.

\textsuperscript{51} As defined in Housing and Regeneration Act 2008, s 79.

\textsuperscript{52} Government has announced that it is making available £163 million in funding under a “Community Housing Fund” which aims to support an increase in affordable housing which will remain affordable in perpetuity. The fund is available to community land trusts and housing co-operatives, amongst others.
12.53 In co-operative housing, a separate entity\textsuperscript{53} will often own the land on which the development stands. The development may then be leased to the co-operative society to provide affordable homes. The value of the land is never passed to the occupiers of these homes, thereby ensuring that the co-operative can continue to provide homes which are affordable. The occupiers of these homes will be members of the co-operative and thereby have some control over the running of the property. If the co-operative is “fully mutual” its members will solely be occupiers, or prospective occupiers, of the housing co-operative.

12.54 Co-operative housing and community land trusts provide housing using a combination of affordable rental tenancies and leases, including shared ownership leases. If co-operatives, or community land trusts, wish to grant leases of more than seven years, they are not currently able to use the commonhold model.\textsuperscript{54} If a co-operative or a community land trust were to provide housing solely on tenancies of less than seven years, then we think such schemes could be established using the commonhold model.

12.55 For example, the co-operative, or community land trust, could own all the commonhold units, as there is nothing in commonhold legislation to prevent an organisation from being a unit owner. The members of the organisation which owns the commonhold units and can vote on decisions of the commonhold association would be (or would include) the tenants of the building. This would satisfy one of the objectives of such schemes; to empower homeowners to make collective decisions about the community.

12.56 Our provisional view is that it is unnecessary to create an exception to the ban on residential leases over seven years for community land trusts and housing co-operatives. The ban on residential leases over seven years does not prevent co-operatives and community land trusts from owning commonhold units and affordably renting these to tenants. In addition, co-operatives and community land trusts would not be prevented from offering shared ownership leases under our provisional proposal at paragraph 12.30 above, to permit certain shared ownership leases within commonhold.

12.57 We would, however, welcome consultees’ views on whether an exception to the ban on residential leases over seven years is needed to accommodate better community land trusts and co-operatives within the commonhold model.

\begin{center}
\textbf{Consultation Question 68.}
\end{center}

12.58 We invite consultees’ views as to whether an exception to the ban on residential leases over seven years is needed to accommodate better community land trusts and co-operatives within the commonhold model.

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\textsuperscript{53} This entity will often be a community land trust (discussed at para 12.52).

\textsuperscript{54} Where leases are granted, these are often for no more than 20 years in duration in order to ensure that the freehold remains in the ownership of the community land trust or housing co-operative. Granting leases of less than 20 years will also mean the leaseholders will not have the statutory right to extend their lease or buy their freehold. These rights are referred to as “enfranchisement rights” and are provided for under the Leasehold Reform Act 1967 and the Leasehold Reform, Housing and Urban Development Act 1993. To be eligible for enfranchisement rights, it is necessary to be a “qualifying tenant”. Qualifying tenants are generally leaseholders holding a lease of over 21 years.
Other forms of affordable housing

12.59 We have considered how a variety of different forms of affordable housing might operate within commonhold. Our provisional view is that the restriction on residential leases will not prevent other types of affordable housing arrangements existing within commonhold, however, we would welcome consultees' views on this point.

12.60 The forms of affordable housing which we consider can be accommodated within commonhold, without any exception to the ban on residential leases, are discussed below.

Right to buy and Right to acquire

12.61 These schemes enable certain public-sector tenants\(^{55}\) to buy their home at a discount, subject to having lived in their property for a specific amount of time. Where a public sector tenant of a commonhold unit satisfies the criteria for exercising the right to buy or acquire, the tenant would be able to purchase the freehold of their commonhold unit at a discount.\(^{56}\) On conversion from leasehold to commonhold, existing public sector tenants would also be able to purchase the freehold of their unit, rather than a lease of their flat.

Help to Buy

12.62 Help to Buy covers a number of Government-backed schemes in both England and Wales. These include (in addition to shared ownership, discussed at paragraph 12.17 above) equity loans, where Government loans a proportion of the value of a property in order to assist with the purchase, and ISAs, where Government adds to the amount saved towards a first home. Shared equity loans and ISAs are not dependent on leases being granted and could assist the purchase of a commonhold unit without changes to the existing commonhold system.

12.63 Shared equity loans are currently offered by the Welsh Government (through Help to Buy (Wales) Ltd) and Homes England under their respective Help to Buy schemes.\(^{57}\) These Help to Buy schemes enable purchasers of new homes to obtain loans typically of up to 20% of the value of the property. For instance, a prospective purchaser may be able to obtain a mortgage to cover 75% of the purchase price and afford a 5% deposit. The remaining 20% may then be provided by Homes England, or Help to Buy (Wales) Ltd, as a shared equity loan. Help to Buy (Wales) Ltd, or Homes England, would be entitled to a charge, secured against the borrower’s property, to protect its 20% share. If the borrower decides to sell the property, he or she will repay 20% of the value of the property, as of the date of sale, to discharge the loan. In this way, the buyer is able to purchase the property for a lower upfront cost and Homes England, or Help to Buy (Wales) Ltd will share in any increase in the value of the property.

\(^{55}\) Namely assured (non-shorthold) tenants of housing associations (although certain assured shorthold tenants also have the right) and secure tenants of local authorities.

\(^{56}\) Although, some consequential amendments are likely to be required to the right to buy and acquire procedures and local authority financing arrangements to accommodate this.

12.64 Shared equity provides a way of achieving a more affordable initial purchase price, without the grant of a lease, and may even be the dominant form of affordable housing in a few areas of England and Wales.\(^{58}\)

12.65 Shared equity is, however, a different product from shared ownership, discussed at paragraph 12.17 above, and serves a different purpose. In particular, the upfront payment required and terms of repayment are different. Help to Buy shared equity schemes are typically limited to a loan of up to 20% of the value of the property, with the remainder requiring a traditional mortgage and deposit. In contrast, a shared ownership purchase can initially be for as little as 25% of a property, with the rest being rented. Shared ownership is therefore more accessible to many because a much smaller initial loan needs to be raised by mortgage. The shared equity loan schemes require repayment within 25 years; the common term of a mortgage. In contrast, as discussed at paragraph 12.19 above, shared ownership leases are almost always granted with terms of 99 years or longer and, while an owner can increase his or her share through staircasing, there is no requirement to do so, this therefore ensures affordability is maintained over a much longer period.

*Rent to Own and Rent to Buy*

12.66 Rent to buy schemes typically offer a reduced monthly rent on a property for a fixed period, usually up to five years, to give the tenant the chance to save for a deposit. At the end of the set period, the tenant may be required to purchase the home, (for instance, through shared ownership), or move on. Rent to Own is a similar scheme offered by the Welsh Government, where 25% of the rent paid is set aside during the tenancy and is available to the tenant as a deposit to buy their property. On purchasing the property, there will also be a discount on the purchase price, representing 50% of any increase in value since the tenant started renting the property.

**Consultation Question 69.**

12.67 Aside from shared ownership leases, community land trusts and housing cooperatives, are consultees aware of any other forms of affordable housing which it is not possible, or would be difficult, to accommodate in the current commonhold system?

12.68 We now go on to discuss the second type of property arrangement which may be prevented within commonhold; lease-based home purchase plans.

**Home purchase plans**

12.69 The traditional prohibition of interest (or “usury”) in Islamic law has resulted in alternatives to interest-based mortgages being created to finance property purchases.

12.70 These alternatives take a variety of forms and include ijara wa iqtina, diminishing musharaka and murabaha. They are regulated by the Financial Conduct Authority under the title of “home purchase plans”. It is understood that the ijara and diminishing musharaka types of arrangement are the main forms of home purchase plan provided for residential purchases in England and Wales and may be increasing in popularity.59

12.71 The ijara and diminishing musharaka forms of Islamic financing rely on leases being granted to the bank’s customers. The terms of leases granted under home purchase plans vary depending on the bank’s criteria, product chosen and amount loaned. Providers of home purchase plans in England and Wales appear to offer leases of up to between 25 and 35 years.60 The current commonhold system does not therefore accommodate these arrangements, due to the general prohibition on residential leases being granted at a premium for terms of more than seven years.61

12.72 Ijara involves the bank purchasing the property and granting a lease to its customer. Rather than charging interest, the rental payments are set so that the bank receives back the amount it paid for the property, plus an additional amount. At the end of the term, or when the arrangement is otherwise ended, the bank undertakes to transfer its freehold interest in the property to the customer, or to a third-party of the customer’s choice.62

12.73 Diminishing musharaka is based on the concept of partnership. The customer contributes an amount to the initial purchase, for instance 25%, and the bank purchases the property, providing a lease to the customer. The customer then pays rent on the property, of which a part is taken as payment to increase the customer’s equity share in the property. The rental amounts decrease as the customer’s share increases. Once the customer has paid enough to achieve 100% ownership, the bank undertakes to transfer the property to the customer. The cost of a share is based on the original purchase price of the property, not its market value at the time the share is purchased.63

12.74 Commonhold would appear to be compatible with the murabaha form of Islamic financing. Murabaha involves the bank buying the property and then immediately selling it on to its customer at an increased price, with the payments being made to the bank in instalments over the term of the arrangement. Murabaha does not therefore involve the use of a lease between the bank and its customer.

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12.75 However, we note the relative scarcity of murabaha type arrangements and the prevalence of ijarah based home purchase plans offered in England and Wales. We understand that a number of the providers of home purchase plans in England and Wales do not offer murabaha type arrangements at all.

12.76 Respondents to our Call for Evidence confirmed that difficulties accommodating Islamic financing in the current commonhold system could act as a deterrent to its use. We are aware that not making an exception for Islamic financing in commonhold may disproportionately impact the Muslim population. It has been reported that, at the time of the 2001 census, the proportion of the Muslim population who owned their own home was significantly lower than the rest of the population, despite an apparently greater desire to move to homeownership.

12.77 We also note that home purchase plans are regulated by the Financial Conduct Authority. This regulation will reduce the risk of the leasehold arrangement being subject to the same abuses which have been seen elsewhere in the leasehold sector.

12.78 We therefore provisionally propose that a limited exception to the ban on residential leases over seven years in commonhold be permitted for home purchase plans regulated by the Financial Conduct Authority.

Consultation Question 70.

12.79 We provisionally propose that an exception to the prohibition on residential leases of over seven years or granted at a premium should be made for lease-based home purchase plans regulated by the Financial Conduct Authority.

Do consultees agree?

Operation of lease-based home purchase plans in commonhold

12.80 To some extent, the considerations which arise in relation to shared ownership leases also arise in relation to lease-based home purchase plans. Both shared ownership leases and home purchase plans provide a way of financing homeownership.

12.81 The operation of lease-based home purchase plans in commonhold raises different issues depending on whether the commonhold is a new development or has been converted from leasehold.

New commonhold developments

12.82 Under our proposals, in new commonhold developments, the bank would be able to purchase the commonhold unit and grant a lease to the customer in the usual way. As with shared ownership leaseholders, we understand that customers of home purchase plans take on many of the same rights and obligations as full owner-occupiers of the

64 See Commonhold: A Call for Evidence – Analysis of Responses, para 8.15.

building. The terms of the lease-based home purchase plan, and any accompanying agreements, could require the customer to comply with the CCS and could delegate certain voting rights to the customer. The bank could reserve the right to vote on particularly important decisions such as the termination of the commonhold. Further, the consent of the bank, as the commonhold unit owner would be needed before making changes to the use, boundaries and rights over the commonhold unit (see paragraph 12.42).

12.83 As explained in paragraph 12.40 above, leaseholders’ statutory right to challenge costs after they have been incurred raises particular difficulties within commonhold. Consequently, we provisionally propose that customers of lease-based home purchase plans should only have the right to challenge any commonhold costs before they have been incurred. This right would replace any existing statutory rights associated with being a residential leaseholder.

Consultation Question 71.

12.84 We provisionally propose that customers of lease-based home purchase plans in new commonhold developments should not have the same statutory rights as other leaseholders to challenge service charge costs or to be consulted on works and contracts exceeding a certain amount.

Do consultees agree?

Conversion to commonhold

12.85 The position on conversion from leasehold to commonhold is less clear. Under our provisional proposals for conversion, only leaseholders who are “qualifying tenants” will be able, or required, to take a commonhold unit on conversion to commonhold. This is discussed in Chapter 3. Whether a customer of a lease-based home purchase plan will be a qualifying tenant will depend on the length of the lease. Only residential leaseholders with leases granted for more than 21 years are qualifying tenants. The terms of leases granted under home purchase plans vary. It is possible for some leases to be granted for less than 21 years, whilst others will be granted for longer.

12.86 Whilst no particular difficulties arise where the customer has a lease of less than 21 years, a problem might arise if the customer has a lease of over 21 years. In this scenario, if the leaseholder decides, or is required, to take a commonhold unit on conversion, the bank’s superior interest would need to be purchased as part of the

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66 Although we understand that the bank retains responsibility for major works of repair to the flat and for obtaining insurance, whilst the customer is responsible for day-to-day repairs. The bank will often appoint the customer as its service agent to undertake major works of maintenance and to obtain insurance, in return for the payment of a fee.

67 These rights are set out predominantly in the Landlord and Tenant Act 1985, ss 18 to 30.

68 Under our provisional proposals, leases of under 21 years would automatically continue on conversion. Following conversion, the bank will either be the unit owner or will have a superior leasehold interest. The relationship between the bank and the customer would therefore be preserved.
conversion process, see Chapter 3. The relationship between the bank and the customer might therefore be brought to an end on conversion to commonhold.

12.87 We understand that the same difficulty already exists within the collective enfranchisement procedure. As part of the enfranchisement process, the leaseholders must buy out the freehold and any leasehold interests which are superior to those of qualifying tenants.

12.88 We ask for consultees’ views on how this difficulty is addressed in practice, and whether there is a way to ensure the relationship between the bank and the customer can be preserved following enfranchisement and conversion to commonhold.

Consultation Question 72.

12.89 We ask consultees for their views and experience of how the relationship between a bank and a customer who is purchasing property through a lease-based home purchase plan is, or can be, preserved following a collective enfranchisement.

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69 Collective enfranchisement enables leaseholders in the building to purchase the freehold of the building together. See further explanation at ch 1, para 1.9.
Part VI: Enforcement and dispute resolution
Chapter 13: Resolving disputes and the protection of minority interests within commonhold

INTRODUCTION

13.1 Regardless of the form of property ownership, disputes with neighbours can be distressing. Where disputes are unresolved they can cause tensions which may continue over a long period of time. These tensions can be compounded where individuals live in close proximity to each other, which will often be the case in commonhold. An effective way of resolving disputes is therefore an essential feature of commonhold.

13.2 There are two kinds of disagreement which we think could arise within a commonhold. The first is where a unit owner or the commonhold association breaches the obligations set out in the commonhold community statement ("CCS"). In such cases, there is a prescribed dispute resolution procedure to assist the parties, and specific enforcement powers to bring the breach to an end. Stakeholders have, however, told us that the current dispute resolution procedure is sometimes overly complex and long-winded and could be improved upon.

13.3 Disputes may still arise even though the terms of the CCS have been complied with. There may be certain decisions made by the commonhold association, which, although valid in that the decision has been taken by a majority of unit owners in accordance with the CCS, cause ill-feeling amongst the minority. Currently, the law does nothing to protect the minority in such a situation.

13.4 In this chapter, we explore these two potential sources of dispute in more detail and present options to make the current system.

DISPUTES ARISING FROM BREACHES OF THE CCS

The current law

13.5 Where it is alleged that a unit owner, tenant or the commonhold association has breached the terms of the CCS, a specific dispute resolution procedure must be followed before taking legal action, unless in an emergency or where the dispute relates to a duty to pay money (in which case the procedure is optional). The procedure only relates to the resolution of disputes which have arisen out of the rights and duties created by the CCS and the 2002 Act.

13.6 In the following chapter, we will explain the options available to the commonhold association where a unit owner breaches the CCS, but the dispute resolution procedure has not satisfactorily resolved the dispute (or where the procedure is optional).

13.7 The dispute resolution procedure to be followed varies depending on whether the unit owner (or tenant) has a complaint against the commonhold association, or vice versa, or where a dispute has arisen between two or more unit owners or tenants. We will outline each of these procedures in turn.
Dispute resolution procedure by a unit owner or tenant against the commonhold association

13.8 In a complaint brought by a unit owner or tenant against the commonhold association, the procedure to be followed is as set out below and in figure 23.

(1) The unit owner or tenant must first consider whether it might be possible to resolve the dispute through negotiation or through a form of alternative dispute resolution such as arbitration, mediation or conciliation.¹

(2) If the matter is not resolved in this way, the unit owner or tenant must serve a complaint notice on the association. The form of this complaint notice is prescribed by the CCS.²

(3) The commonhold association must serve a prescribed reply notice³ on the unit owner or tenant.

(4) If the commonhold association replies or fails to reply within 21 days, and the unit owner or tenant is still dissatisfied, he or she must first reconsider whether it would be possible to resolve the dispute through negotiation or alternative dispute resolution.

(5) If the matter is still not resolved and the commonhold association is a member of an approved ombudsman scheme, the unit owner or tenant must refer the matter to an ombudsman. No legal proceedings may be brought until the ombudsman has investigated and provided a determination.

(6) If the commonhold association is not a member of an approved ombudsman scheme, or if the matter remains unresolved after an ombudsman determination, only then can the unit owner or tenant commence legal proceedings.⁴

¹ We discuss these forms of alternative dispute resolution in more detail at para 13.35 below.
² The form to be used is “Form 17” Commonhold Regulations 2004, sch 4.
³ The form to be used is “Form 18” Commonhold Regulations 2004, sch 4.
⁴ Commonhold Regulations 2004, sch 3 paras 4.11.4 to 4.11.9. However, no approved ombudsman scheme has been introduced.
Figure 23: dispute resolution procedure by unit owner or tenant against commonhold association

Unit owner or tenant MUST consider negotiating directly or using alternative dispute resolution

not resolved

Serve complaint notice (Form 17)

Commonhold association replies to complaint notice (Form 18)

satisfied

Unit owner or tenant MUST again consider negotiating directly or using alternative dispute resolution

dissatisfied

resolved

Is commonhold association a member of an ombudsman scheme?

Yes

Take no further action

satisfied

Commence legal proceedings

No

Unit owner or tenant MUST apply to ombudsman and wait for notification of decision

unsatisfied
13.9 The procedure is generally the same as that set out above except that:

(1) before commencing legal proceedings, the commonhold association may, in addition to considering negotiation and alternative dispute resolution, consider whether taking no action would be in the best interests of the commonhold; and

(2) even where there is an approved ombudsman scheme, the commonhold association may choose to bypass a referral to the ombudsman where it would be in the interests of the commonhold to proceed straight to legal proceedings.

The procedure to be followed by the commonhold association against a unit owner or tenant is set out in figure 24.

5 Commonhold Regulations 2004, sch 3 para 4.11.12.
6 Commonhold Regulations 2004, sch 3 para 4.11.16.
Figure 24: dispute resolution procedure by commonhold association against unit owner or tenant

Commonhold association MUST consider: negotiating directly; or using alternative dispute resolution; or taking no action

not resolved

Commonhold association serves a default notice (Form 19)

Unit owner, or tenant, replies on Form 20 within 21 days?

Yes

No

Commonhold association MUST again consider negotiating directly or using alternative dispute resolution

Is commonhold association a member of an ombudsman scheme?

Yes

No

Commonhold association can choose to refer to ombudsman

Refers to ombudsman

Does not refer to ombudsman

Commonhold association MAY, if it is satisfied that the interests of the commonhold require it, bring legal proceedings

satisfied

unsatisfied

Commence legal proceedings

Take no further action

Unit owner, or tenant, accepts finding

Unit owner, or tenant, rejects, or disregards, finding

Finds for unit owner or tenant

Finds for commonhold association

resolved

commonhold association satisfied

resolved

resolved
Procedure for enforcement between two or more unit owners or tenants

13.10 The procedure to be followed between unit owners (and/or their tenants) is as set out below and in figure 25.7

(1) The unit owner, or tenant, must consider resolving the dispute through negotiation or alternative dispute resolution.

(2) If the matter cannot be resolved in this way, the unit owner must serve a prescribed notice on the commonhold association asking the commonhold association to enforce the right or obligation against the other party.8

(3) The commonhold association must consider this request and decide whether or not to take action to enforce the right or duty.

(4) The commonhold association can decide not to take any action where inaction is:

(a) in the best interests of establishing, or maintaining, harmonious relationships between all the unit owners or tenants; and

(b) will not cause significant loss or disadvantage to any tenant or unit owner (other than the defaulter).

(5) The commonhold association may also prevent the unit owner, or tenant, from taking direct legal action against the other party. However, it can only do this where it reasonably considers there to be no breach of right or duty or where the complaint is vexations, frivolous or trivial.

(6) The commonhold association must, as soon as practicable after making its decision, notify the unit owner or tenant of the decision. If the association does not do so on the correct form,9 or a form to the same effect, within 21 days, the unit owner or tenant will be able to take direct legal action against the other party.

(7) If the commonhold association refuses to take action or prevents the unit owner or tenant from bringing his or her own claim, then the unit owner or tenant can challenge the decision of the commonhold association (using the procedure for bringing a complaint against the commonhold association set out in paragraph 13.8 above). However, in this instance, the commonhold association must respond to the complaint notice within seven, rather than 21, days.

(8) Where the commonhold association has decided it will not take action but has not prevented the unit owner or tenant from taking direct action (or has failed to reply), the unit owner or tenant must serve a prescribed notice on the other party before doing so.

(9) The other party must then serve a prescribed reply notice.

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7 Commonhold Regulations 2004, sch 3 paras 4.11.17 to 4.11.30.
8 The form to be used is “Form 21” Commonhold Regulations 2004, sch 4.
9 The form to be used is “Form 22” Commonhold Regulations 2004, sch 4.
(10) If the other party replies or fails to reply within 21 days, and the unit owner or tenant is still dissatisfied, he or she must first reconsider whether it would be possible to resolve the dispute through negotiation or alternative dispute resolution.

(11) If still dissatisfied, the unit owner or tenant may commence legal proceedings.
Figure 25: dispute resolution procedure by unit owner or tenant against unit owner or tenant

Unit owner or tenant MUST consider negotiating directly or using alternative dispute resolution.

resolved

Unit owner or tenant MUST serve request for action on commonhold association (Form 21)

Commonhold association MUST consider request

No reply from commonhold association within 21 days

Is inaction in best interests of establishing and maintaining harmonious relationships; AND inaction will not cause significant loss or disadvantage to any tenant or unit owner (other than the defaulter)?

No

As soon as possible, reply to request for action (Form 22) accepting request to take action

Yes

As soon as possible, reply to request for action (Form 22) refusing to take action

Does the association also refuse complainant right to take direct action as, reasonably, thinks: - no breach; OR - vexatious, frivolous or trivial?

Unit owner or tenant takes direct action by complaint notice to defaulter (Form 23)

Reply notice (Form 24)

No reply notice (Form 24) within 21 days

dissatisfied

Yes

No

Challenge decision following procedure in figure 23 (commonhold association has 7 days from complaint notice, rather than 21, to reply on Form 19).

Unit owner or tenant MUST again consider negotiating directly or using alternative dispute resolution

unresolved

Bring legal proceedings

resolved

Take no further action

As soon as possible, commonhold association takes action per procedure in figure 24.
Criticisms of the current law

13.11 As explained in Chapter 1, at the same time as publishing our Call for Evidence, we also sent a commonhold survey to existing commonhold owners and managers. We received 31 responses. Amongst other questions, our survey asked unit owners whether they had used the dispute resolution procedure and how effective they found the procedure to be.

13.12 The vast majority of those responding to this question said that they had not been involved in any disputes within commonhold. Of those with experience of disputes, none gave any negative feedback or raised concerns regarding the dispute resolution procedure. In fact, one respondent strongly agreed that the procedure was quick, easy to understand and easy to follow.

13.13 In response to our Call for Evidence, the Conveyancing Association stated that it had previously conducted a survey of existing unit owners and that “of those who had experienced disputes they ranked their satisfaction with the dispute resolution process as 3.6/5”. Respondents also commented positively on the procedure’s emphasis on alternative dispute resolution and they discussed the advantage of resolving disputes outside of court.

13.14 However, other respondents to our Call for Evidence raised issues with how the existing dispute resolution procedure operates. Some queried whether there should be a mandatory procedure at all where no such procedure exists for disputes within leasehold.

13.15 The procedure for resolving disputes between unit owners (or their tenants) drew particular criticism, being described as “long drawn out and, while no doubt well-intentioned, appears bureaucratic”.

13.16 The use of prescribed forms also raised concern, with one respondent noting:

the procedure includes the compulsory use of prescribed forms and 21 day notices. In practice an association which comprises a group of flat owners in a small commonhold will have neither the knowledge nor the skill to do this so that if they are compelled to go to court against an intransigent unit [owner], the claim may be struck out because Form 19 or 20 was not used. Experience with the forms required for collective enfranchisement indicates the sort of technical point which a defendant might take. I suggest this is too prescriptive.

Proposals for reform

13.17 In response to our Call for Evidence consultees raised three specific issues with the dispute resolution process; firstly, whether such a mandatory procedure is necessary; secondly; that the procedure is long-winded in places and thirdly, that the use of prescribed forms may “catch out” those using the procedure. We address each of these

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10 The Conveyancing Association said that it had received 24 responses to its survey.
11 See Commonhold: A Call for Evidence – Analysis of Responses, para 3.33.
12 See Commonhold: A Call for Evidence – Analysis of Responses, para 3.31.
13 See Commonhold: A Call for Evidence – Analysis of Responses, para 3.32.
specific concerns and provide our proposals for reform. After addressing these concerns, we set out more generally how we envisage a revised procedure could operate.

Stakeholders’ specific concerns

The mandatory nature of the dispute resolution procedure

13.18 A number of respondents to the Call for Evidence were under the misapprehension that the dispute resolution procedure was mandatory in all cases. Respondents raised concerns that this would be inappropriate in the event of money being owed or in an emergency. In fact, the current dispute resolution procedure states that if it is an emergency, or if the dispute relates to a duty to pay money, the complainant is not required to use the procedure, although he or she may choose to do so.

13.19 One consultee to our Call for Evidence suggested that the dispute resolution procedure should be made optional in all cases (not just in emergencies or in relation to breaches of financial obligations).

13.20 As explained above, we received largely positive feedback from existing commonhold unit owners and associations regarding the dispute resolution procedure (especially as the procedure encourages settlement of disputes without the need to go to court). In view of this positive feedback, we do not currently propose making the procedure optional; however we provisionally propose reforms aimed at simplifying and improving the existing procedure.

Simplifying the procedure – disputes between unit owners

13.21 Despite the generally positive feedback from unit owners and commonhold associations, we agree with respondents to the Call for Evidence that there are opportunities to make the procedure more effective.

13.22 The procedure for resolving disputes between two or more unit owners or tenants involves a particularly lengthy process. There are three different stages a unit owner (or tenant) is required to work through in order to obtain a remedy. First, a unit owner, or tenant, is required to request that the commonhold association takes action on his or her behalf. Second, if the association declines to do so and does not give the unit owner, or tenant, the right to pursue the matter directly (because the claim is vexatious, frivolous or trivial or it considers that no breach has occurred), the unit owner or tenant, needs to challenge that decision before taking further action. The procedure for resolving disputes taken by the unit owner or tenant against the association, (set out in paragraph 13.8 above) must therefore be used. Thirdly, if the complainant’s challenge is successful, and the unit owner or tenant is permitted to take direct action against the other unit owner or tenant, the complainant must follow another prescribed procedure to take action against the other unit owner or tenant (set out in paragraph 13.10 above).

13.23 Whilst we appreciate that the commonhold association has a particular role to play in preventing breaches and enforcing the CCS,¹⁴ we think the association’s ability to prevent a unit owner from taking direct action could prolong the dispute unnecessarily.

¹⁴ See ch 14.
13.24 We are conscious that a commonhold association, not being a judicial body, may incorrectly decide that a claim is vexatious, frivolous or trivial or that no breach of the CCS has occurred. In this situation, the unit owner needs to successfully challenge the association’s decision before being able to take direction against the other unit owner. During this time, the breach would remain unresolved, causing unnecessary delay.

13.25 We therefore provisionally propose that the association should not be permitted to prevent a unit owner from taking direct action against another owner. That being said, we do see merit in the association being able to advise the unit owner if it considers the claim to be vexatious, frivolous or trivial or that no breach has occurred. Being given this advice by a third-party may cause the unit owner to reconsider the matter and potentially dissuade him or her from unnecessarily pursuing the matter further. If legal proceedings are ultimately pursued, the court can take into account the conduct of parties to a dispute when deciding what costs order to make. For example, where a unit owner has pursued a claim, despite the commonhold association providing notice that it considers the dispute to be vexatious, frivolous or trivial, the court can consider if a party has acted unreasonably in pursuing a claim and may order that party to pay some, or all, of the other party’s legal costs incurred in having to defend the claim.

Consultation Question 73.

13.26 We provisionally propose that the commonhold association should not be able to prevent a unit owner or tenant from pursuing direct legal action against another unit owner or tenant. Instead, the association should have the right to notify the unit owner or tenant that it reasonably considers the claim to be frivolous, vexatious or trivial or that the matter complained of is not a breach of the CCS.

Do consultees agree?

Use of prescribed forms

13.27 Some respondents to our Call for Evidence considered the requirement to use prescribed forms as part of the dispute resolution procedure too prescriptive, effectively creating a trap for the unwary.

13.28 Whilst the wording of the CCS says that specific forms “must be used” there is some ambiguity. Clarke on Commonhold suggests that the Commonhold Regulations allow “forms to the same effect” to be used instead.

13.29 The forms are short, at a page in length each and, in our view, are clear and easy to complete. A couple of example forms are attached in Appendix 7 to this Consultation

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15 Civil Procedure Rules r 44.2(4)(a).
16 Commonhold Regulations 2004, reg 16.
17 See Commonhold: A Call for Evidence – Analysis of Responses, para 3.32.
19 Clarke on Commonhold para 19[12], footnote 4.
Paper. The information on the forms highlight the steps that should be taken before serving the particular notice, such as considering alternative dispute resolution. We hope that the use of such forms will assist in encouraging parties to resolve the disagreement outside of the court. The forms also provide a structure for unit owners who may have no previous experience of how disputes should be resolved within a commonhold.

13.30 We do, however, accept stakeholders’ concerns that mistakes in the use of prescribed forms should not be used by the other party tactically or as a way of delaying the process. Instead, the forms should be used as a tool to assist parties to comply with the procedure and make the process easier. Therefore, we consider that even where an incorrect form is used, the claim should be allowed to progress. If the dispute ends up before the court (or under our suggested proposal below, the First-tier Tribunal (Property Chamber) in England and the Residential Property Tribunal Wales (“the Tribunal”)), we provisionally propose that the court or Tribunal should be able to take into account the extent of compliance with the procedure when deciding what costs order to make. We do not think a party should be penalised for failing to use a particular form where otherwise the party has followed the spirit of the procedure by considering alternative dispute resolution, setting out his or her complaint and allowing the other party an opportunity to reply.

13.31 We consider it beneficial to remove any ambiguity and to make clear that although there is an expectation that the prescribed forms will be used, a failure to do so will not prevent the claim from proceeding. Instead, we propose that a court (or the Tribunal) should be able to take into account the extent of compliance with the procedure, as will be discussed further below.

Consultation Question 74.

13.32 We provisionally propose that a failure to use the forms which accompany the commonhold dispute resolution procedure, or forms to the same effect, should not automatically prevent a claim from progressing.

Do consultees agree?

The dispute resolution procedure more generally

13.33 We now consider the dispute resolution process more generally, explaining the options for reform. We set out each of the existing stages of the dispute resolution procedure; the requirement to consider alternative dispute resolution, the time limits for responding to complaint notices and the requirement to make a referral to an ombudsman scheme. We also consider the consequences of failing to comply with the procedure and whether, as an alternative to the procedure, a specific pre-action protocol could be created that would apply. Finally, we consider what would happen if the dispute remains unresolved and legal action is taken.
Alternative dispute resolution

13.34 We agree with respondents that the procedure’s emphasis on informal methods of dispute resolution is important. The dispute resolution procedure within commonhold should be aimed at resolving the dispute quickly, amicably and cheaply, avoiding court proceedings wherever possible.

13.35 The dispute resolution procedure for commonhold encourages the use of informal processes by requiring the complainant to consider negotiation and alternative dispute resolution at various stages of the process. The process points to arbitration, mediation and conciliation as particular forms of alternative dispute resolution which may be used. We explain each of these terms further below.

(1) Arbitration involves asking a third-party (the arbitrator) to decide the dispute. In agreeing to arbitrate, the parties accept that the decision will bind them. The defined object of arbitration is “to reach a fair and impartial resolution without unnecessary delay or expense.”

(2) In mediation, the third-party helps the two parties resolve the dispute between themselves through a structured discussion.

(3) Conciliation is similar to mediation, in that the parties are brought together to resolve their dispute through discussion. Sometimes the conciliator may be asked to give his or her own opinion on the dispute, which the parties can agree to be bound by.

(4) Another process is called “early neutral evaluation”. This form of alternative dispute resolution involves a third-party, who is often a specialist on the subject matter of the dispute, giving an opinion on the dispute. The opinion can be used to guide negotiations and may be sufficient to encourage a party not to pursue the matter further, or to agree to reach a settlement.

13.36 We consider that each commonhold could usefully set out in the CCS the approach it wishes to take to resolve disputes informally. Unit owners would therefore be familiar with the steps that should be taken each time they have a complaint. The appropriate response to a dispute could realistically vary from commonhold association to commonhold association. For example, it may be appropriate to name a certain individual or company (such as a managing agent or other third-party) to whom complaints could be sent in the first instance. That person could give advice on the parties’ rights and obligations within the commonhold which, in many cases, may be sufficient to resolve the dispute. The nominated person may also be able to provide the parties with guidance on what other forms of informal dispute resolution may be appropriate.

13.37 The Call for Evidence highlighted certain misconceptions about the use of alternative dispute resolution procedures. In particular, a number of respondents referred to the requirement in the current system to use mediation, or other alternative dispute

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20 Arbitration Act 1996, s 1(a).

resolution procedures, to resolve disputes. Some of these respondents considered this requirement to be a positive aspect of commonhold and some considered it to be negative; causing unnecessary delay.

13.38 The current legislation recognises that alternative dispute resolution may not be appropriate in all circumstances. Instead of requiring it, it therefore places a duty on the complainant to consider the use of alternative dispute resolution. If the complainant decides alternative dispute resolution to be inappropriate, he or she is free to continue to the next stage of the process without delay.

13.39 We are of the view that whilst informal procedures will often be useful in helping to resolve the dispute, there may be cases in which use of alternative dispute resolution could be inappropriate and may delay matters. This may be the case, for instance, where a unit owner has already repeatedly failed to engage with attempts at alternative dispute resolution, or perhaps has been aggressive or violent. We do not think the use of alternative dispute resolution should be made mandatory in every case and therefore do not propose any amendment to the current law.

Service of notices

13.40 The commonhold dispute resolution procedure generally requires responses to notices (such as the complaint notice, default notice or request for action) within 21 days.

13.41 We consider 21 days to be a reasonable period of time in which to consider and respond to notices. Whilst reducing the period of time would allow an action to progress faster, we are concerned that a shorter period of time may prevent a respondent from being able to properly consider its position and reply. As already noted, if the matter is an emergency, the complainant is able to choose not to follow the prescribed dispute resolution procedure.

Referral to an ombudsman

13.42 Where a complaint is brought against the commonhold association, the 2002 Act currently requires the unit owner, or tenant, after having considered alternative dispute resolution, to refer the dispute to an ombudsman. The 2002 Act provides for the creation of an “approved ombudsman scheme” to facilitate the resolution of disputes between unit owners and the commonhold association. However, no such scheme has ever been created.

13.43 The Call for Evidence generated a number of responses regarding the availability of an ombudsman. Five consultees indicated that an approved ombudsman service would be a positive development for commonhold. No one disapproved of the use of such a scheme.

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22 One exception being where a unit owner or tenant is challenging a commonhold association’s decision not to take action against another unit owner or tenant, or its refusal to permit the unit owner or tenant to take direct action him or herself. In this case the association must provide a response within seven days.

23 Except where the commonhold association is not a member of an approved ombudsman.

24 CLRA 2002, s 42.

25 Commonhold Call for Evidence, para 1.50.
13.44 We agree with consultees that the use of an ombudsman service may, in many cases, assist with the resolution of disputes. However, we consider there to be a number of reasons why the current requirement to be a member of and to use an ombudsman service may not be appropriate.

13.45 The dispute resolution procedure currently envisages that a unit owner or tenant would not be required to accept an ombudsman decision. However, the ombudsman’s decision would, in theory, bind a commonhold association. The unit owner or tenant is therefore free to disregard an ombudsman’s finding, whilst the commonhold association is bound to follow it. This practice perhaps highlights a fundamental difference between the ombudsman’s current role and its potential role in commonhold. Currently, the ombudsman’s role is generally to help individuals obtain redress against businesses or public bodies. An individual may therefore continue to pursue a complaint against a business despite the rejection of its case by an ombudsman, but a business is expected to comply with the decision, even if it does not agree with it.

13.46 We consider that commonhold does not fit comfortably alongside the existing types of disputes which may be referred to ombudsman schemes. While the commonhold association is a company, it is set up to enable unit owners to manage the commonhold effectively. Its members are the unit owners themselves, who are able to exercise control over the commonhold through their voting rights. The commonhold association is not therefore a third-party organisation over which a unit owner has no control. This contrasts with the position in existing ombudsman schemes, to assist consumers in disputes with, for instance, financial services. As the authors of Clarke on Commonhold have put it “a commonhold association is not a business; it is a community.”

13.47 Additionally, unit owners would need to pay for membership of any approved ombudsman scheme through their commonhold contributions. Membership of an ombudsman scheme is therefore an additional cost in commonhold which is not required in the running of most leasehold properties.

13.48 The current requirement to use an ombudsman, and to await its decision before pursuing legal proceedings, also adds a further stage to the dispute resolution process. Referral to an ombudsman is currently required in disputes raised by unit owners, or tenants, against the commonhold association. The current procedure is set out at paragraph 13.8 above and in figure 23. This procedure requires the unit owner, or tenant, to consider alternative dispute resolution, serve a complaint notice, wait 21 days (if there is no earlier response) and then again consider alternative dispute resolution. Having completed these steps, the unit owner, or tenant, is required to refer the complaint to the ombudsman. The unit owner or tenant then cannot pursue legal proceedings until the ombudsman has considered the complaint and he or she has received notification of its decision. No time limit is specified for the ombudsman’s decision to be reached and notified to the unit owner or tenant. If the matter does ultimately need to be pursued through legal proceedings, the requirement to make an

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26 CLRA 2002, s 42(2)(g) requires a commonhold association to comply with an ombudsman decision, however, the Law Commission notes reports regarding non-compliance with ombudsman decisions in other sectors, see for instance A Tims, Now it's time for a crackdown, as ombudsman service labelled ‘a shambles’ The Observer (29 October 2017).

27 Clarke on Commonhold, para 16[39].
ombudsman referral adds an additional step in the process and an uncertain amount of time before the matter can be pursued through legal proceedings.

13.49 Referral to an ombudsman is also currently required where the dispute is initially between two, or more, unit owners or tenants, and the commonhold association refuses to take action and refuses the unit owner, or tenant, permission to pursue the matter. The dispute is then treated as one between the unit owner (or tenant) and the association, and the complainant is required to follow the procedure set out at paragraph 13.8 above (and in figure 23). As explained in the previous paragraph, this requires notification of the decision of the ombudsman before legal proceedings can be pursued.

13.50 It is of course hoped that referral to an ombudsman will prevent the need for legal proceedings. However, we are conscious of the fact that where a referral to an ombudsman, is required in addition to considering alternative dispute resolution, and legal proceedings still follow, considerable delay and uncertainty is caused until the dispute is finally resolved.

13.51 We consider that the use of an ombudsman could still be a beneficial part of the dispute resolution process, but provisionally propose that membership and use of an ombudsman should be optional. Commonhold associations could choose to sign up to an ombudsman scheme and use such schemes instead of, or alongside, other forms of alternative dispute resolution, such as those which are discussed at paragraphs 13.34 to 13.35(4) above. The use of an ombudsman would therefore be a part of the consideration of alternative dispute resolution, rather than a separate, additional required step in the dispute resolution process.

Consultation Question 75.

13.52 We provisionally propose that referral to an ombudsman should not be a mandatory part of commonhold’s dispute resolution procedure. Instead, it could be used on an optional basis, instead of, or alongside, other forms of alternative dispute resolution.

Do consultees agree?

13.53 We provisionally propose that membership of an approved ombudsman scheme should no longer be a requirement for commonhold associations, and that, instead, commonhold associations should be able to decide whether or not to become a member of an ombudsman scheme.

Do consultees agree?

Sanctions for failure to follow the commonhold dispute resolution procedure

13.54 The commonhold dispute resolution procedure must be followed unless in an emergency, or if the breach of the CCS is financial. However, where the procedure is not followed, there are no sanctions expressly set out in the legislation.
13.55 Since the extent of compliance, and reasons for non-compliance, are likely to vary depending on the individual circumstances of the dispute, we do not propose any specific order that should be made by the court or Tribunal. Instead the court or Tribunal should have full discretion, within its case management powers, to take into account, or disregard, the extent of non-compliance with the dispute resolution procedure and direct the parties as it considers appropriate in the circumstances. By way of example only, we envisage that possible sanctions could include costs consequences (particularly if the non-compliance was deliberate, or aimed to put the other party at a disadvantage) or adjourning proceedings to allow an opportunity for steps to be taken to address the non-compliance.

**Consultation Question 76.**

13.56 We provisionally propose that, where the dispute resolution procedure has not been followed, any court or tribunal, which subsequently considers the dispute, should have full discretion to disregard the non-compliance, or to order the parties to take any steps it considers appropriate, in accordance with its general case management powers.

Do consultees agree?

13.57 Instead of the dispute resolution procedure being mandated in the CCS, a new specific pre-action protocol could be created which would need to be followed before any claim could be commenced in the court. We set out advantages and disadvantages of doing so below, and ask for consultees' views.

A new pre-action protocol

13.58 Pre-action protocols set out steps which should be followed before court proceedings are started. They are annexed to the Civil Procedure Rules, which are the rules governing the conduct of litigation in the civil courts in England and Wales, including the county court. The Civil Procedure Rules, and therefore the pre-action protocols, do not apply in the Tribunal, which operate according to a different set of rules. Currently, only the court has jurisdiction to hear disputes arising from breaches of the CCS.

13.59 There is no specific pre-action protocol for commonhold disputes, although the dispute resolution process within commonhold shares a number of similarities with the protocols. In particular, the objectives of pre-action protocols are similar to those of the commonhold dispute resolution procedure. These objectives are to:

1. understand each other’s position;
2. make decisions about how to proceed;
3. try to settle the issues without proceedings;
4. consider a form of alternative dispute resolution to assist with settlement;
5. support the efficient management of those proceedings; and
(6) reduce the costs of resolving the dispute.\textsuperscript{28}

13.60 Where a relevant pre-action protocol has not been followed, the court can disregard the breaches, or bring a temporary halt to proceedings (referred to as "staying proceedings") while the necessary steps are taken. The court also has the power to apply sanctions, for example, the court could require one party to pay costs to the other party, as a penalty for failing to comply with the protocol.\textsuperscript{29} The Civil Procedure Rules specifically state that the court "is not likely to be concerned with minor or technical infringements, especially when the matter is urgent."\textsuperscript{30}

13.61 We think there could be advantages in creating a specific pre-action protocol for commonhold disputes that would replace, to a large extent, the dispute resolution procedure set out in the CCS. We consider that creating a specific pre-action protocol would avoid the risk of overlap with other existing protocols.

13.62 Since the commonhold legislation came into force in 2004, the number of pre-action protocols has expanded significantly. Protocols now cover a range of property and housing-related disputes, including housing disrepair, possession claims by social landlords, possession claims for mortgage arrears and dilapidation\textsuperscript{31} of commercial property. There is also a general pre-action protocol, which applies where there is no specific protocol for the type of claim being brought.

13.63 We are aware that, with the increasing number of pre-action protocols, there is potential that commonhold disputes may also fall within the scope of one or more specific pre-action protocols as well as the general procedure.

13.64 Instead of a detailed list of rules within the CCS, the CCS could direct parties to the relevant pre-action protocol which applies to disputes within a commonhold. A copy of the latest protocol could also be provided to unit owners when they purchase the property, and subsequently on request.

13.65 As set out in paragraph 13.58 above, the Tribunal is not governed by the Civil Procedure Rules, to which the pre-action protocols are annexed. The pre-action protocols therefore do not apply in the Tribunal. Instead, the Tribunal has a general discretion regarding case management and the use of alternative dispute resolution which ensures a greater degree of flexibility once a case reaches it.

13.66 Below we discuss whether commonhold disputes could, in fact, be referred to the Tribunal. If consultees agree that commonhold disputes should be dealt with by the Tribunal, rather than the court, then it may be preferable to keep the commonhold dispute resolution procedure within the CCS, rather than as a separate pre-action protocol.

\textsuperscript{28} Civil Procedure Rules, Practice Direction – Pre-Action Conduct and Protocols, para 3.
\textsuperscript{29} Civil Procedure Rules, Practice Direction – Pre-Action Conduct and Protocols, para 15.
\textsuperscript{31} Where repair work has not been carried out in breach of a lease.
Consultation Question 77.

13.67 We invite consultees’ views as to whether the current commonhold dispute resolution procedure should be transferred to a pre-action protocol.

13.68 If the dispute resolution procedure set out in the CCS is unsuccessful in resolving the dispute, the parties may decide to take legal proceedings. As explained above, currently, only the court has the jurisdiction to hear commonhold disputes. However, certain respondents to our Call for Evidence suggested there could be a role for the Tribunal in resolving commonhold disputes, as we now discuss.

Role of the Tribunal

13.69 The option to use the Tribunal to assist with the resolution of commonhold disputes, instead of the court, was considered prior to the introduction of commonhold. The creation of a specific commonhold tribunal was rejected, mainly due to concerns over funding and initial lack of work.

13.70 Professor David Clarke has previously noted the expertise that the Tribunal has in resolving leasehold disputes, which have parallels with the types of disputes that arise in commonhold. Several respondents to our Call for Evidence were in favour of permitting a tribunal to consider commonhold disputes. Some respondents suggested a specialist commonhold tribunal, while others suggested that the First-tier Tribunal (Property Chamber) or Residential Property Tribunal in Wales would be an appropriate forum.

13.71 We consider that, due to the small number of commonholds which currently exist, the creation of a specialist tribunal dealing solely with commonhold disputes would not be practicable at present. The merits of a separate tribunal may fall to be reviewed in the future, following a significant increase in the number of commonholds. Instead, if a tribunal is to be given jurisdiction over commonhold disputes, we provisionally propose extending the jurisdiction of the First-tier Tribunal (Property Chamber) or Residential Property Tribunal in Wales.

13.72 The potential benefits of giving the Tribunal jurisdiction over commonhold disputes, rather than the courts, include the expertise of a specialist property tribunal, the relatively informal proceedings (in comparison to court proceedings), and the reduced emphasis on legal representation. These benefits should result in claims being pursued at a lower cost, although we note the comments in Parliament that these benefits are not always being achieved in practice.

35 Commonhold: A Call for Evidence – Analysis of Responses, for instance see paras 3.37 and 3.38.
36 Commonhold: A Call for Evidence – Analysis of Responses, for instance see para 3.39.
13.73 There may also be certain drawbacks in directing complainants to apply to the Tribunal. The Tribunal does not have the power to grant injunctions (which is an order requiring someone to perform a certain action or stop performing an action) and so, where a breach of the CCS continues despite the Tribunal’s order, the complainant may still need to apply to court for an injunction. However, the Tribunal will already have done the fact-finding for the court, and will have decided whether a breach has occurred. Although the division of jurisdiction between the Tribunal and courts is beyond the scope of our current project, we note recent discussions, including the Ministry of Housing, Communities and Local Government’s current call for evidence, regarding merging the property work of the courts and Tribunal to create a “one-stop shop”.

13.74 Currently, the Tribunal predominantly considers residential disputes between landlords and tenants. The commonhold dispute resolution procedure, however, applies equally to disputes involving commercial unit owners and disputes between two, or more, unit owners or tenants.

13.75 Providing the Tribunal with jurisdiction to decide all commonhold disputes would therefore represent a change to the current nature of the disputes it handles. However, we consider that the potential benefits that giving the Tribunal jurisdiction may provide would be equally valuable in disputes solely between unit owners and tenants, or involving commercial unit owners.

Consultation Question 78.

13.76 We provisionally propose that the jurisdiction of the First-tier Tribunal (Property Chamber) in England and the Residential Property Tribunal Wales should be extended to cover disputes arising within a commonhold.

Do consultees agree?

Recovery of costs of legal proceedings

13.77 Resolving disputes usually results in costs being incurred. For instance, where a commonhold association has employed professional managing agents to carry out its day-to-day activities, these agents will expect to charge for the time spent handling any complaint made in relation to breaches of the CCS. Costs may also be incurred if alternative dispute resolution is entered into with a third-party and if the matter proceeds to court or if legal advice is required.

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39 HM Courts and Tribunal Service has announced a pilot scheme under which the First-tier Tribunal (Property Chamber) is handling unopposed business lease renewals under the Landlord and Tenant Act 1954 which were commenced in the Central London County Court.
The question arises of who should pay for these costs. Where the costs fall to the commonhold association, it will ultimately be the unit owners who pay these costs through the commonhold contributions. Where a unit owner has pursued a complaint against the commonhold association for breaching the CCS and the complaint is upheld, that unit owner would still have to contribute towards the cost of this action through the commonhold contributions. In leasehold, there is a power for a tenant to apply to the Tribunal to prevent any costs incurred by the landlord from being reclaimed from the leaseholders.\textsuperscript{40} There is no similar provision for commonhold.

The difficulty applying the same provision to commonhold is that a commonhold association is made up of the unit owners. The association’s income will usually be limited to the commonhold contributions paid by unit owners. If the Tribunal prevented the commonhold association from reclaiming the costs from any of the unit owners it would have no available means of paying the amounts it had incurred, potentially resulting in an insolvency situation. The risk of being unable to recover costs may deter directors of the commonhold association from defending legal proceedings brought by unit owners against it, even where those complaints have little merit.

We therefore do not currently propose the introduction of any provision to prevent a commonhold association from reclaiming the costs of any dispute from all unit owners through the commonhold contributions.

The considerations may be slightly different where it is a unit owner or tenant that is in breach. At the time that the 2002 Act was being debated, there were plans to include an indemnity provision in the model CCS. This indemnity would have entitled a unit owner, or commonhold association, to seek compensation from a unit owner who breaches the terms of the CCS and causes them a loss. It was intended that the commonhold association would serve a notice requiring the unit owner to pay the amount due. This was referred to as an indemnity notice. The indemnity provision was ultimately not included as a standard part of the CCS, but unit owners can choose to add a provision to this effect in the CCS if they want to.\textsuperscript{41}

### Consultation Question 79.

We invite consultees’ views as to whether the prescribed CCS should include a provision that, where a unit owner or tenant breaches the rules of the CCS, the unit owner, or tenant, should be required to indemnify the other unit owners and the commonhold association for any losses they reasonably incur as a result of the breach.

\textsuperscript{40} Landlord and Tenant Act 1985, s 20C.

\textsuperscript{41} See discussion of this in G Fetherstonhaugh, M Sefton and E Peters Commonhold (1\textsuperscript{st} ed 2004) p 241.
PROTECTING MINORITY INTERESTS WITHIN COMMONHOLD

13.83 We now turn to the situation where, despite the commonhold association complying with the CCS in making a decision, the decision is contested by one or more members of the minority.

The current law

13.84 Commonhold is intended to operate in a democratic manner. Unit owners can make collective decisions about how their building is run by a certain majority. Currently most decisions which are required to be made by the unit owners can be made by simple majority of over 50%. Under the current model, the principle of democracy applies strictly – what the majority wants to happen is what happens. Once a decision has been validly taken, there are no mechanisms in place for the minority of unit owners to challenge the decision.

Criticisms of the current law

13.85 Whilst collective decision making is one of the key features of commonhold, we are concerned that there may be circumstances in which it is inappropriate for the principles of majority rule to apply strictly. In these cases, decisions made by the majority could have particularly undesirable or prejudicial consequences for the minority and may give rise to disputes and ill-feeling amongst those unit owners within the commonhold.

Proposals for reform

13.86 The balance between majority rule and minority protection has been a recurring theme within our Consultation Paper. In several chapters, we make proposals aimed at striking a fairer balance between these competing ideas. In particular, in Chapter 8 we set out options to increase the voting threshold necessary to make certain decisions in order to protect unit owners’ expectations when they buy their units.

13.87 Even after increasing the threshold of support required to make certain decisions, there are particular areas in which we think greater minority protection is warranted. In a number of chapters, we suggest that the minority should be able to make an application to the Tribunal when faced with a particularly unfavourable decision. We now consider how such a right might operate in practice.

A new right to apply to the Tribunal

13.88 We do not think the right to apply to the Tribunal should be a general one, which would make every decision of the commonhold susceptible to challenge. To allow such a general right would undermine the democratic nature of the commonhold and would make commonhold administratively difficult. Instead, to strike the necessary balance between majority rule and minority protection, our view is that the basic principles of democracy should apply unless greater protection is required.

42 Decisions of the commonhold association are either taken by the unit owners collectively, (following a vote in a meeting or following the written resolution procedure), or by the directors acting on behalf of the unit owners. The directors are appointed by the unit owners and can be removed by them. Additionally, the unit owners may (by special resolution) require the directors to take, or refrain from taking, any prescribed course of action.
Elsewhere in this Paper, we suggest that a unit owner in the minority could have the right to apply to the Tribunal in the following circumstances:

1. Where the commonhold association approves a budget, which will result in costs above a threshold (set in the CCS) being incurred on works or enhanced services (see Chapter 10). In such instances, the minority would be required to make an application to the Tribunal pre-emptively before the costs are incurred;

2. Where the minority are outvoted on a decision to vary the local rules of the CCS (see Chapter 8);

3. Where a committee, set up to represent a section of the commonhold, has had powers delegated to it, and the unit owners in the section wish to prevent these powers being revoked or amended. Unit owners may have purchased the unit with the expectation that their section committee would retain certain powers (see Chapter 5);

4. We suggest that unit owners should be able to apply to the Tribunal if they are opposed to the introduction of a new section or the combination of two or more sections (see Chapter 5).

We invite consultees’ views as to whether it should be possible for a member of the minority to apply to the Tribunal in any other circumstance.

**Consultation Question 80.**

Elsewhere in this Consultation Paper we provisionally propose that it should be possible for a unit owner (or owners) to apply to the First-tier Tribunal (Property Chamber) in England or the Residential Property Tribunal Wales to challenge a decision of the commonhold association in the following circumstances:

1. Where the commonhold association approves a budget, which will result in costs above a threshold (set in the CCS) being incurred on works or enhanced services;

2. Where the minority are outvoted on a decision to vary the local rules of the CCS;

3. If the directors of the association delegate powers to a committee which has been set up to represent a section of the commonhold, and the unit owners in the section wish to prevent the directors revoking or amending these powers;

4. Where the unit owner, or owners, are opposed to the introduction of a new section or the combination of two or more sections.

We invite consultees’ views as to whether there are any other circumstances in which it would be appropriate to provide a unit owner (or owners) with a right to challenge a decision taken by the commonhold association.
Whilst we have already highlighted the circumstances in which we think it would be appropriate to provide members of the minority with a right to apply to the Tribunal, we have not yet considered the test which might be applied by the Tribunal, or the remedies which should be available.

Test to be applied by the Tribunal

13.93 We invite consultees’ views as to the extent to which some or all of the following factors should be taken into account by the Tribunal when deciding whether or not to grant a remedy to a unit owner in the minority. At this stage, we do not make any proposals as to the exact terminology to be used within the test. Any terms used below are merely to illustrate the underlying policy for a new regime. We are not attempting to identify the appropriate statutory wording to give effect to that policy.

13.94 In order to be eligible for a remedy:

(1) Should the unit owner making the application have voted against the decision complained of, or have a good reason for not doing so?

(2) Does the decision complained of need to have a particular impact on the unit owner making the application? By way of an example, the majority of unit owners vote to approve the cost of replacing the roof of the commonhold building. Two unit owners vote against these costs being incurred, instead preferring “patch” works to the roof. One unit owner has the financial means to pay for the repairs, but simply does not think the works are necessary. The other unit owner cannot afford the works and would be placed in financial difficulty. Should both unit owners be entitled to a remedy in these circumstances, or solely the unit owner faced with financial difficulties? In other words, is it necessary for the unit owner to be able to point to some hardship resulting from the decision?

(3) If some degree of impact is necessary, what degree of impact needs to be demonstrated by the unit owner? For example, is it only necessary to point to some degree of hardship or must such hardship be “substantial” or “significant”? We note here the difficulty of choosing a term which adequately reflects the degree of loss or hardship. However, as explained above, we are not currently looking to draft the test. Instead, we are trying to ascertain, as a matter of policy, the level of protection that should be provided to unit owners. To take another example, assume that the majority of unit owners seek to vary the CCS to ban pets. One unit owner does not have any pets, but was considering buying a dog in the future. Another unit owner already has a dog and would be faced with finding a new home for the dog, or moving out of the commonhold. Should both unit owners be eligible to obtain a remedy in the Tribunal or just the second owner? In other words, what degree of hardship should unit owners be required to demonstrate in order to obtain a remedy from the Tribunal?

(4) To what extent is the reason behind the decision taken by the majority relevant? For example, one unit owner wishes to challenge the cost of works to replace flat doors in the commonhold as she/he cannot afford them. Should it make a

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43 For example, the meaning of substantial can range from “not little” or “not insubstantial” to “almost complete” Badger Trust v The Welsh Ministers [2010] EWCA Civ 807.
difference whether the commonhold association wants to replace the doors solely for decorative purposes, or to provide an enhanced degree of security? Should the Tribunal be able to provide a remedy in both scenarios or solely in the latter? In other words, should the Tribunal take into account the reasons behind the decision complained of (such as whether the decision is in the best interests of the commonhold) and whether the decision is proportionate to the impact on the unit owner?

Consultation Question 81.

13.95 We invite consultees’ views as to the extent to which the following factors should be taken into account by the First-tier Tribunal (Property Chamber) and the Residential Property Tribunal Wales when deciding whether or not to grant a remedy to a unit owner who challenges a decision taken by the commonhold association:

(1) Whether or not the unit owner(s) making the application voted against the decision complained of, or had a good reason for not doing so.

(2) Whether the decision complained of needs to have a particular impact on the unit owner (or owners) and if so, what degree of impact.

(3) The reason behind the decision taken by the commonhold association, for example, whether the decision is in the best interests of the commonhold and/or is proportionate to the impact on the unit owner in question.

13.96 We also invite consultees’ views on whether the same factors would be relevant in all of the circumstances set out in Consultation Question 80 where a unit owner may have the right to apply to the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal (Wales).

Remedies available

13.97 After considering the unit owner’s application, we provisionally propose that the Tribunal should either allow the decision to stand or annul the decision taken by the commonhold association. If the Tribunal allows the decision to stand, we propose that the Tribunal should be able to attach conditions to its decision. Conditions could include requiring compensation to be paid to the applicant or limiting the effects of the decision. For example, the Tribunal could agree for the CCS to be varied to prevent future commonhold owners from owning pets, on condition that existing owners are allowed to keep their pets.
Consultation Question 82.

13.98 We provisionally propose that on an application by a unit owner challenging a decision of the commonhold association, the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal (Wales) should be able to allow the decision to stand or annul the decision. If the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal (Wales) allows the decision to stand, we propose that the Tribunal should be able to attach conditions to its decision.

Do consultees agree?
Chapter 14: Enforcement

INTRODUCTION

14.1 In the previous chapter, we discussed how disputes may be resolved within commonhold. Where disputes do arise, we anticipate the disagreement will centre on the interpretation of rights and obligations under the commonhold community statement (“CCS”). Once it has been established that a breach of the CCS has occurred, there will need to be mechanisms in place to bring the breach to an end as quickly as possible.

14.2 Compliance with the CCS is particularly important within commonhold. Commonhold, by its nature, involves numerous individuals whose properties and interests are interconnected. The actions of one unit owner could potentially affect all other owners within the commonhold. To protect other unit owners and ensure the smooth running of the commonhold, the CCS sets out a number of duties which unit owners must comply with.

14.3 The commonhold association has a particular role to play in ensuring that the rules of the CCS are followed. Its directors must prevent, so far as possible, the disruption of unit owners in their properties. To do so, directors must use the powers available to the commonhold association for the purpose of “preventing, remedying or curtailing” any breach of the CCS, unless taking action would not be in the best interests of the commonhold.\(^\text{44}\)

14.4 However, concerns have been raised that the commonhold association does not have sufficient powers to enforce compliance with the CCS. In particular, several stakeholders argue that there is no effective way for the association to enforce payment of commonhold contributions.\(^\text{45}\) This omission is especially concerning because the failure of one unit owner to pay his or her share of the commonhold contributions could increase the sums payable by others.\(^\text{46}\) In extreme cases, such as where a number of unit owners persistently fail to pay their contributions, the solvency of the commonhold association could be put at risk.

14.5 In this chapter we will set out the enforcement powers that are currently available to the commonhold association where a unit owner breaches the terms of the CCS. We then

\(^{44}\) CLRA 2002, s 35.
\(^{45}\) “Commonhold contributions” include the shared cost contribution (which covers day-to-day costs of the commonhold, such as the costs of management and maintenance) and the reserve fund contribution.
\(^{46}\) If one unit owner does not pay his or her commonhold contributions, this could lead to a shortfall in the sums available to meet the debts of the commonhold association (for example, sums due to a contractor for works on the commonhold building). To meet the shortfall, the directors of the association could decide to make further demands for contributions or alternatively arrange a loan or bank overdraft to bridge the shortfall until the debt is repaid. However, demands for contributions may become unavoidable if it is clear that a defaulting unit owner will not be able to pay, for example, if the owner become bankrupt. In this case, the debt would need to be written off and the other owners asked to meet the shortfall. The ways the association can raise funds are discussed in more detail in chs 10 and 11.
explore the case for improving the association’s powers so that the commonhold can operate as effectively and as fairly as possible.

THE CURRENT LAW

14.6 Different powers are available to the commonhold association depending on whether the breach of the CCS relates to the payment of commonhold contributions or some other obligation. We first set out the position where the breach does not relate to financial provisions of the CCS and then go on to explain the powers which apply where the breach is financial.

Non-financial breaches of the CCS

14.7 Where the breach of the CCS is non-financial (for example, a breach of a local rule prohibiting pets or requiring unit owners to maintain their properties), the commonhold association is generally required to follow a prescribed dispute resolution procedure before taking legal action against the unit owner. This procedure is discussed in more detail in Chapter 13.

14.8 Once it has been established that a breach of the CCS has occurred, the association does not have any enforcement powers against the unit owner which are specific to commonhold. The commonhold association has the same enforcement powers as any other party to a contractual agreement which has been breached. The association will be able to apply to court for an award of compensation for any loss caused by the breach. However, in many cases it may be difficult to point to any financial loss suffered by the association as a result of the breach. Additionally, compensation will not, by itself, be effective in bringing the breach to an end. The association can instead apply for an injunction against the unit owner, which is a court order requiring the unit owner to perform a particular action or stop performing an action. For example, an order could be sought requiring the unit owner to comply with a rule which requires the owner to allow access to the unit for a safety inspection.

14.9 If the unit owner breaches the terms of the injunction (for example, by continuing to refuse access for the safety inspection), the unit owner may be guilty of “contempt of court”. The commonhold association would be able to make an application to court

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47 A local rule is a provision in the CCS which is specific to that particular commonhold, rather than one which is required by law to apply to all commonholds.

48 There is an exception in the case of emergencies (see ch 13, para 13.5).

49 There is an argument, however, that where a unit owner breaches an obligation in the CCS which requires him or her to take a certain positive action, proceedings should be for specific performance of the CCS, rather than an injunction. See Clarke on Commonhold, para 19[16]. However, as noted in this text, the sanctions for breaching an order for specific performance would be the same as for an injunction. The procedure for applying for an interim injunction is governed by Civil Procedure Rules, r 25 and can generally only be made after a claim has been issued in court. When deciding whether to grant an injunction the court will consider (amongst other factors), if it is just and convenient to order the injunction, whether there has been a delay in bringing the action and whether damages would be sufficient instead to redress the breach: see Senior Courts Act 1981, s 37 and County Courts Act 1984, s38. See also American Cyanamid v Ethicon [1975] AC 396.

50 In order to be guilty of an offence of contempt, it must be shown, beyond reasonable doubt, that the unit owner has breached the terms of the injunction. Failure to comply with a court order will not automatically be a contempt of court, for instance in Sectorguard Plc v Dienne Plc [2009] EWHC 2693 (Ch), despite not
(referred to as “committal proceedings”) asking for a sanction to be imposed on the unit owner.\textsuperscript{51} The court has a range of sanctions available, including the payment of a fine or, in more serious cases, a prison sentence.\textsuperscript{52}

### Financial breaches of the CCS

14.10 If a unit owner fails to pay the commonhold contributions (which includes the shared cost contribution for day-to-day costs of running the commonhold and the reserve fund contribution) it is open to the commonhold association to follow the dispute resolution procedure as set out in the previous chapter. However, the dispute resolution procedure is only likely to assist where it is unclear whether the sums have been validly demanded in accordance with the CCS. As explained in Chapter 10, there is no opportunity for unit owners to challenge the reasonableness of commonhold costs after they have been incurred.

14.11 Where the association has demanded costs in accordance with the provisions of the CCS, and the sums remain unpaid, then the association may decide to proceed straight to enforcement action.

14.12 The CCS provides the commonhold association with two powers, specific to commonhold, when faced with the non-payment of commonhold contributions. Additionally, the association would have the same enforcement powers as are available to any other person owed money from the unit owner. The options available – both under the general law and those specific to commonhold associations – are discussed in more detail below.

### Powers specific to commonhold associations

14.13 The two powers specific to commonhold associations are the power to charge interest and the diversion of rent from a tenant.

#### Interest

14.14 Whenever a unit owner fails to pay the commonhold contributions on time, he or she must pay interest to the commonhold association at the rate prescribed in Annex 4 of the CCS.\textsuperscript{53} The CCS allows those setting up the commonhold to insert their own rate of interest into the annex of the CCS. If no provision has been made, the default rate of interest is 0%.\textsuperscript{54} Charging interest is not a means of enforcing non-payment, but provides an incentive for unit owners to pay contributions on time.

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\textsuperscript{51} The procedure to be followed for committal is governed by Civil Procedure Rules, r 81 and 23. Committal proceedings are only possible where the injunction order served on the unit owner contains a warning that, if the owner breaches the injunction, he or she could be guilty of contempt of court. This warning is known as a “penal notice”. Civil Procedure Rules, r 81.9.

\textsuperscript{52} Sanctions will be imposed to “punish those who flout its authority and to compel compliance in the future”: Broomleigh Housing Association Ltd v Okonkwo [2010] EWCA Civ 1113, [2010] 10 WLUK 264. (Currently, the maximum custodial sentence is two years, and the maximum fine is £2500 – Contempt of Court Act 1981, s 14).

\textsuperscript{53} Commonhold Regulations 2004, sch 3 paras 4.2.16 to 4.2.42.

\textsuperscript{54} Commonhold Regulations 2004, reg 15(6).
Diversion of rent from a tenant

14.15 If a unit owner fails to pay the commonhold contributions, and the unit has been rented out to a tenant, the commonhold association may require the tenant to pay any rent due under the tenancy agreement to the association instead of the unit owner. In other words, the commonhold association can direct that the tenant pays rent that is due to the unit owner directly to the commonhold association. This enforcement mechanism is referred to in the CCS as “diversion of rent”. The diversion of rent procedure works in the following way.

(1) The commonhold association will give notice to the tenant that all or part of the rent due must be paid to the association instead of the unit owner.\(^{55}\)

(2) The association must specify the payments the tenant must make, and the date on which each payment is due.\(^ {56}\) However:

(a) the amount required at each payment date cannot exceed the rent which would be payable by the tenant under the tenancy agreement; and

(b) the dates for payment must be at least 14 days from the date of the association’s notice. Additionally, payments cannot be required earlier than the date on which rent would be due under the tenancy agreement.\(^ {57}\)

(3) Payments made by the tenant:

(a) satisfy the tenant’s obligation to pay rent to the unit owner;\(^ {58}\) and

(b) satisfy the unit owner’s obligation to pay the association.\(^ {59}\)

(4) If the tenant is late in making a payment, then the tenant must pay interest at the rate set out in the CCS.\(^ {60}\)

(5) These payments can continue until the full amount owed by the unit owner is recovered.\(^ {61}\)

(6) Once the full amount has been recovered, the association has 14 days in which to notify the unit owner and the tenant that the diversion of rent procedure has ended.\(^ {62}\)

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\(^{55}\) Commonhold Regulations 2004, sch 3 para 4.2.18.

\(^{56}\) Commonhold Regulations 2004, sch 3 para 4.2.19.

\(^{57}\) Commonhold Regulations 2004, sch 3 para 4.2.21. If the association fails to state a date for payment in the notice, the default is the date on which rent would normally be payable under the tenancy agreement (provided this is at least 14 days from the date of the notice).

\(^{58}\) Commonhold Regulations 2004, sch 3 para 4.2.24(b).

\(^{59}\) Commonhold Regulations 2004, sch 3 para 4.2.24(a).

\(^{60}\) Commonhold Regulations 2004, sch 3 para 4.2.26.

\(^{61}\) Commonhold Regulations 2004, sch 3 para 4.2.18.

\(^{62}\) Commonhold Regulations 2004, sch 3 para 4.2.22.
14.16 If the tenant fails to make these payments, any sub-tenant can be required to divert rent to the commonhold association under the same procedure outlined above. If the sub-tenant fails to make payments, any inferior sub-tenant can be required to divert rent, and so on. If any tenant or sub-tenant suffers a loss as a result of the rent diversion procedure, the unit owner must reimburse him or her.

14.17 To facilitate the diversion of rent procedure, the commonhold association can require unit owners and their tenants to confirm the length of any tenancy in place and the rent payable. The parties involved have 14 days within which to provide the requested information.

**General powers as a creditor**

14.18 In addition to the above, the commonhold association has the same enforcement powers as any other person who is owed money from the unit owner. In particular, the association is able to bring a money claim in the county court or commence bankruptcy proceedings against the unit owner. We provide a summary of these options below.

**Money judgment**

14.19 The commonhold association may apply to court for a money judgment (which is a court order confirming that one party owes an amount of money to another) against the defaulting unit owner. Once obtained, the association can enforce the judgment in a number of ways. Enforcement in this context is the process of ensuring that the sums owed are actually repaid.

14.20 Obtaining and enforcing a money judgment is a complex and time-consuming process. The association will need to follow the procedure summarised below:

1. The association submits a money claim to court and pay the associated court fee. The fee varies in accordance with the amount of money being claimed.

2. The unit owner has 14 days to either acknowledge the claim or file a defence. If the unit owner fails to do either, the association is entitled to apply for a money judgment without a court hearing. If, however, the unit owner defends the claim, it is necessary for the parties to follow a number of procedural steps leading to a final hearing of the claim, such as preparing and serving evidence. The parties can also ask for the proceedings to be put on hold whilst they try and negotiate an agreement.

63 Commonhold Regulations 2004, sch 3 paras 4.2.27 to 4.2.37.
64 Commonhold Regulations 2004, sch 3 para 4.2.38.
65 Commonhold Regulations 2004, sch 3 para 4.2.39 and 4.2.40.
66 Commonhold Regulations 2004, sch 3 para 4.2.41 and 4.2.42.
67 For example (where the claim is not made online) the fee would be £35 where the amount of money owed is up to £300. This would increase to £455 where the amount claimed is between £5,000 and £10,000: see HM Courts and Tribunals Service, EX 50 Civil and Family Court Fees: from July 2018 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728133/ex50-eng.pdf.
68 If the unit owner files an acknowledgment of service, this would extend the time limit for serving a defence to 28 days from service of the commonhold association’s claim.
(3) The unit owner and the association will be given at least 21 days' notice of the court hearing. At the hearing, the court will decide whether or not to grant the money judgment. If the court grants the judgment, it will also set the terms on which the amount will be repayable. For example, the money may be payable immediately, after a certain period of time, or in instalments. 69

14.21 After obtaining the money judgment, the commonhold association will need to make a further application to court to enforce the judgment if the unit owner fails to pay. There are a variety of ways in which a money judgment may be enforced. For example, if the defaulting unit owner is employed, the association will be able to seek an order requiring the employer to pay sums from the unit owner’s earnings to the association. Alternatively, the association can seek an order requiring a bailiff to attend the unit owner’s property to collect and sell the owner’s possessions. The association can also apply for a charging order over the defaulting owner’s unit and then apply to court for the sale of the property.

14.22 If the commonhold association decides to enforce the money judgment by way of a charging order, it will need to take further steps. The association will first need to apply for an interim charging order at court. 70 If the court grants the interim charging order, it will next arrange a hearing to consider whether the charging order should be made final. 71 Once a final charging order is made, the association will be able to apply to court for the sale of the unit. 72 If the court decides, at a further hearing, that the unit should be sold, the unit owner will usually be given 28 days in which to either pay the debt or leave the property. If the unit owner does not vacate the property, then the association will need to make an additional application to court for a possession warrant. 73

Bankruptcy proceedings

14.23 The commonhold association can apply to court to make a unit owner bankrupt where he or she owes the association £5,000 or more and where it appears that the unit owner has “no reasonable prospect of being able to pay”. 74

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69 Civil Procedure Rules, r 40.11(a).
70 Form N379: Practice Direction 73 para 1.1. The association would be able to apply for a charging order straight away, whether or not the unit owner was up to date with any instalment payments agreed at the judgment stage: Charging Orders Act 1979, s 1(7).
71 The unit owner would have 28 days within which to file any written objections to the order becoming final. If the unit owner fails to file an objection, a judge will consider the application without a hearing: Civil Procedure Rules, r 73.10. If a final charging order is made, the unit owner would be able to apply for the order to be discharged or varied: Civil Procedure Rules, r 73.10B.
72 Civil Procedure Rules, r 73.10C. Again, the unit owner would have the ability to contest the claim by filing written evidence. However, if the unit owner fails to respond to the claim, the commonhold association will not be automatically entitled to an order for the sale of the property.
73 Civil Procedure Rules, r 83.
74 Insolvency Act 1986, s267(2) and (5). The commonhold association must pay a court fee of £280, plus a £990 “petition deposit” towards the costs of managing the bankruptcy. Where the bankruptcy petition is withdrawn or dismissed, the petitioner deposit will be returned less £50 in respect of an administration fee: Insolvency Proceedings (Fees) Order 2016.
14.24 In order to demonstrate the unit owner’s inability to pay, the association must first have served a demand for payment in a prescribed form (known as a “statutory demand”) on the unit owner requiring the debtor to pay. If the unit owner fails to pay the sum demanded within 21 days, then the association will be able to file a bankruptcy petition at court.

14.25 The court would then set a date for a hearing at which the court decides whether or not to make the unit owner bankrupt. If a bankruptcy order is made, then a responsible person, known as the “trustee in bankruptcy” is appointed. The trustee will take control of the unit owner’s assets, including his or her unit, and will look to sell them in order to pay off the unit owner’s debts. If a trustee in bankruptcy wishes to sell a unit to discharge debts, the trustee would need to make an application to court. A statutory scheme exists to determine when the court should order sale.

CRITICISMS OF THE CURRENT LAW

Non-financial breaches of the CCS

14.26 Although we did not ask a specific question on this point in our Call for Evidence, some respondents recommended enhancing the commonhold association’s enforcement powers faced with non-financial breaches of the CCS.

14.27 We are aware that in other jurisdictions, the commonhold association-equivalent is given greater powers to tackle non-financial breaches of the commonhold rules. In particular:

1. **Fines** – in New South Wales (Australia) and British Columbia (Canada), the association is able to impose fines on unit owners who breach the rules of their building. The Uniform Common Interest Ownership Act (“UCIOA”), which sets out a model statute which can be adopted by the individual states in the USA, also provides the association with the ability to impose fines. A tribunal order is required before imposing such a fine in New South Wales, but not under the UCIOA or in British Columbia, where the association can impose fines directly on its unit owners.

2. **Access restrictions** – in British Columbia, the association has the power to deny access to recreational facilities for a reasonable length of time.

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75 This demand requires the debtor to pay the outstanding sum within 21 days (or apply to set aside the demand).
76 The hearing must be at least 14 days after service of the bankruptcy petition on the unit owner. The unit owner could oppose the bankruptcy by filing a notice of opposition at least 5 days before the hearing: Insolvency (England and Wales) Rules 2016, rr 10.21, 10.18 and 10.24. The court could also decide to postpone making the decision to a future date.
77 The trustee in bankruptcy will either be the official receiver (who is a civil servant in the Insolvency Service and an officer of the court) or an insolvency practitioner subsequently appointed.
78 The scheme is contained in the Insolvency Act 1986.
79 See Commonhold: Comparative Research, paras 2.89, 3.73(4)(a) and 5.95 for more information.
80 See Commonhold: Comparative Research, para 3.73(4)(c).
“Self-help” – additionally in British Columbia, the association has the power to do whatever is reasonably necessary to remedy the breach in question, for example, working on a unit owner’s property or removing objects from common parts.81

14.28 In Germany, if an apartment owner remains in “gross breach” of his or her obligations despite warnings, the other owners can, by majority vote, require that owner to sell his or her apartment. The owner is able to avoid the sale until the last moment, by fulfilling the obligations in which he or she is in breach.82 A few respondents to our Call for Evidence recommended replicating such powers in commonhold by giving the commonhold association the power to sell a unit in the event of a serious breach. We consider such a penalty to be a disproportionate response to non-financial breaches of the CCS and so we do not propose to introduce this power in commonhold.

14.29 However, we are mindful of the importance of compliance with the CCS and the effect non-compliance can have on life within the commonhold. Currently, the commonhold association does not have any specific powers available to address non-financial breaches of the CCS and must rely on the powers available under general law. We do not think that the powers available under general law are necessarily sufficient. As identified above, it may be difficult for the association to seek compensation from the unit owner, as the breach may not have caused any financial loss. Additionally, obtaining an injunction is a costly and time-consuming exercise. In particular, injunctions which require someone to take a positive action (“mandatory injunctions”) are difficult to enforce. The ultimate sanction for breaching an injunction is imprisonment, but, if sent to prison, the unit owner will not be in a position to take steps to end the breach.

14.30 We would be grateful for consultees’ views on whether the commonhold association should be given enhanced powers when faced with non-financial breaches of the CCS, perhaps by following the approach of other jurisdictions outlined above.

Consultation Question 83.

14.31 We invite consultees’ views as to whether the commonhold association should be provided with enhanced powers to address non-financial breaches of the CCS.

If so, what should these powers be?

Financial breaches of the CCS

14.32 Stakeholders have not referred to any concerns regarding the commonhold association’s ability to charge interest on late payments of commonhold contributions. One stakeholder argued that the rent diversion procedure would be “unattractive” to buy-to-let landlords, however no concerns were raised over the usefulness or operation of this procedure. Whilst we are minded to retain the diversion of rent procedure in its

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81 Strata Property Act 1998, s 133.
82 Wohnungseigentumsgesetz (WEG) 1951, ss 18 and 19. This power is also available where the owner has not paid costs and expenses for over three months.
current form, we are concerned about the absence of any regulation on the interest which may be charged by the commonhold association. This absence of regulation could leave unit owners vulnerable to excessive and punitive amounts. We therefore make a provisional proposal for reform regarding interest in paragraph 14.43 below.

14.33 Stakeholders’ main concern, in the context of financial breaches of the CCS, appears to be that the specific powers available to the commonhold association are insufficient. This view is shared both by those responding to our Call for Evidence and commentators. The ability to charge interest does not itself provide a means of recouping the sums that are owed and will not always act as a deterrent. The diversion of rent procedure only assists where the unit owner has let his or her property on a tenancy agreement. If the tenant refuses to co-operate, the association would be entitled to charge the tenant interest on the sums demanded.

14.34 In most cases, the commonhold association is left in the same position as any other person who is owed money from a unit owner. The association is required to seek a money judgment or bring bankruptcy proceedings against the unit owner. As we have seen, the procedure for doing so is complex and time consuming and requires the payment of court fees. Obtaining a money judgment can realistically take several months, or even years. During this time, sums which are owed to the commonhold association continues to accrue and the association incurs court and legal fees. Once the money judgment is obtained, the association will still need to enforce the judgment. However, each of the enforcement options discussed in paragraph 14.21 above have limitations. For example, there is a limit on the sums which may be deducted from a unit owners’ earnings and paid to the association. Additionally, a charging order over the property will only be useful where there is sufficient value (or “equity”) in the property. The amount received from the sale of the property will need to be sufficient to pay back any mortgage lender (and any other lenders) with an existing charge over the property before the association can be repaid.

14.35 One respondent to our Call for Evidence summarised the difficulty with the current enforcement procedure as follows:

the process is long, drawn out and expensive and in the meantime the association is deprived of income. An unscrupulous unit owner has opportunities to procrastinate. The other unit owners have to live with the defaulting unit owner and cover any

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83 See Commonhold: A Call for Evidence – Analysis of Responses, paras 8.5 to 8.9.


85 Up to a certain level, the unit owners’ earnings will be “protected” to ensure the owner has sufficient funds to meet living expenses. See Attachment of Earnings Act 1971, s 6.
shortfall in maintenance costs and will have to meet the expenses including a failed arbitration or mediation.

14.36 We agree that non-payment of contributions can create significant difficulties for a commonhold. If unit owners regularly do not pay their commonhold contributions, there may be insufficient funds to meet the costs of maintenance and pay contractors. This shortfall could lead to additional sums being demanded from the other owners until the sums can be recovered. If those to whom the commonhold association owes money remain unpaid, the result could be that legal proceedings are brought to wind up the association for insolvency. The effects of insolvency are discussed in Chapter 7. Whilst unit owners are not at risk of losing their homes on the association’s insolvency, they may be left without an adequate management structure to regulate the relationship between the separate freehold properties. 86

14.37 To make commonhold attractive to homeowners, we consider it is essential that unit owners are protected, so far as possible, from subsidising other homeowners. We therefore think enhanced enforcement powers will bolster this protection.

14.38 Effective enforcement powers will also assist in ensuring that funds are available for the adequate maintenance of the property. 87 Maintenance of the property is of concern to owners and mortgage lenders alike. In response to our Call for Evidence, mortgage lenders addressed the importance of commonholds being adequately maintained to preserve the value of the property over which they have a secured interest. 88 An additional concern of lenders is to ensure that their security is protected in the unlikely event of the commonhold association’s insolvency. Whilst we suggest measures which will better protect lenders on insolvency (see Chapter 7), it will be far preferable to avoid an insolvency situation in the first place. A healthy cash flow within the commonhold association is the primary way of maintaining the solvency of the association.

14.39 The same structural interdependence which is likely to exist between commonhold units, is also found in leasehold blocks, although there is a key difference. Unless leaseholders own the freehold collectively, 89 an external freeholder is responsible for maintaining the common parts of the block. Some external freeholders may be better placed to bear any temporary shortfall in the payment of service charges than leaseholders themselves, although we appreciate this will not always be the case. In a commonhold, the unit owners themselves (or through their appointed directors) will be responsible for ensuring the building is maintained and for paying the associated costs. There is no external third-party to bear any temporary shortfall of commonhold costs.

14.40 Landlords of leasehold properties also have stronger enforcement powers than those within commonhold. Landlords are able to bring a defaulting owner’s lease to an end by exercising their right to forfeit. Leaseholders who have collectively purchased the freehold of the building will also have this power. Whilst landlords must take a number

86 See ch 5 for an explanation of the difficulties created by freehold flats outside of the commonhold management structure (known as “flying freeholds”).

87 In response to our Call for Evidence, a law society said that a lack of an efficient system for the recovery of contributions may “lead to a deterioration of the conditions of the building and common parts”.

88 See Commonhold: A Call for Evidence – Analysis of Responses, question 7.

89 Leaseholders may own the freehold collectively in a number of circumstances (see ch 2, n 16).
of preliminary steps before being able to forfeit (which will include a court order where the lease is of residential property) the effects of forfeiture are particularly severe. Forfeiture enables the landlord to bring the leasehold interest to an end. The landlord takes back the property, not merely recovers the outstanding debt. Hence, the landlord is not required to pay any money to the leaseholder even when the property is worth more than the debt owed. The leaseholder may have paid a significant amount to purchase the leasehold interest in the flat (often referred to as “the premium”), but this investment would be lost on forfeiture.

14.41 Whilst we accept that forfeiture can offer a deterrent effect,\(^{90}\) we do not propose to replicate the power of forfeiture within commonhold. As we have noted in Chapter 7, the absence of forfeiture is one of the advantages commonhold has over leasehold. Further, in fact, the Law Commission has already proposed the abolition of forfeiture within residential leasehold in its report Termination of Tenancies for Tenant Default.\(^{91}\) We consider forfeiture to be a disproportionate penalty which would go beyond that required to recover outstanding costs and would often create a windfall for the commonhold association.\(^{92}\) For example, the Leasehold Knowledge Partnership recently reported on a £600,000 London maisonette being forfeited due to the leaseholder’s failure to seek consent to carry out redecoration works.\(^{93}\)

14.42 We agree, however, with stakeholders’ concerns that the current powers available to the commonhold association to recover commonhold costs are inadequate. We consider that the association should be in a better position to recover sums than others who are owed money from unit owners. However, we think the association’s powers should stop short of the enforcement powers available to landlords in residential leasehold. Our proposed reforms should provide greater protection for unit owners and lenders where certain owners fail to pay their share, without imposing excessive, disproportionate penalties, such as forfeiture, on the defaulters.

PROPOSALS FOR REFORM

Interest

14.43 We provisionally propose to retain the ability of the commonhold association to set the rate of interest which may be charged on late payments of commonhold contributions in the CCS, subject to one amendment. As explained above, we are concerned that currently, there is no limit on the amount of interest that may be charged on overdue payments and that this may be subject to abuse. We propose that there should be a statutory cap on the amount of interest that may be charged on late payments, which

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\(^{90}\) Two consultees responding to our Call for Evidence referred to the deterrent effect of forfeiture. One says, the “remedy of forfeiture helps to ensure that service charges are paid in a leasehold system”.


\(^{92}\) Three members of the public and one RTMCo considered the absence of forfeiture to provide an advantage of commonhold over leasehold. Financial institutions also considered the lack of forfeiture to be an advantage. One financial institution says, “If a borrower has a leasehold property, and is faced with forfeiture, that borrower’s lender is also at risk of losing its interest in the property as a result.”

may be amended by Government from time to time. A similar proposal was made in the 1987 Aldridge Report which suggested that the rate of interest could be linked to the interest payable on judgment debts.  

Consultation Question 84.

14.44 We provisionally propose that a statutory cap should be introduced on the rate of interest which may be charged by the commonhold association on late payments of commonhold contributions.

Do consultees agree?

Enhancing the powers of the commonhold association – a statutory charge

14.45 The 1987 Aldridge Report and the subsequent 1990 and 1996 iterations of commonhold legislation recommended that the commonhold association should have a first legal charge over all commonhold units to secure the payment of commonhold contributions. The charge would take effect automatically on registration of the commonhold unit and would have priority over any mortgages secured over the unit. If the unit owner failed to pay his or her share of the contributions, the association would have the ultimate remedy of forcing the sale of the unit to recover the debt. After repaying the debts due to the commonhold association, the proceeds of sale would be used to pay off any subsequent charges, such as a mortgage. Any sums remaining would then be returned to the unit owner.

14.46 Precedent for such a charge can be found in other jurisdictions. In particular, the UCIOA suggests an interesting compromise between the mortgage lender and the commonhold association. Under the UCIOA, the association is provided with an automatic charge over the unit. However, the association’s charge only takes priority over other secured interests (such as the unit owner’s mortgage) up to the amount of six months’ contribution a year. In British Columbia (Canada), the approach is slightly different. Rather than the charge applying automatically, the association is only able to register a charge over a unit if the unit owner fails to pay the sums due within two weeks of a demand.

14.47 We see the merit in providing the commonhold association with a charge over commonhold units. However, we are mindful of ensuring that there are adequate protections in place for defaulting unit owners and mortgage lenders.

Advantages of a first legal charge and impact on mortgage lenders

14.48 We consider that a charge over commonhold units in favour of the commonhold association will protect other unit owners in the event that some owners fail to pay their share of the commonhold contributions. It will mean that the association is able to take

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94 Commonhold: Freehold Flats and freehold ownership of other interdependent buildings: Report of the Working Group Law Commission (1987) Cm 179, para 9.22: “To be realistic, the interest rate will have to vary from time to time, and therefore be prescribed by regulation. It could be linked to the rate of interest payable on judgment debts”.

95 Uniform Common Interest Ownership Act (as amended in 2014), s 3-116.
swifter enforcement action to sell a defaulting unit owner’s property and to pay the arrears. In turn, this will reduce the risk of other owners being required to make up the shortfall in the meantime.

14.49 A statutory charge over units will also protect the association if a defaulting unit owner becomes bankrupt.\textsuperscript{96} If the association has a charge, it will be guaranteed an amount of money from the proceeds of sale of the unit, provided there is sufficient value in the property. Otherwise, the association will have to share any value remaining with any others who are owed money by the unit owner, after those with the benefit of a charge have been repaid. On a bankruptcy, such persons often do not receive the full amount they are owed.

14.50 We also think that, to be effective, any charge granted in favour of the commonhold association should take priority over other charges, such as mortgages. This priority means that on the sale of the property, the association will be repaid its debt first. If this were not the case, there may be no remaining value (“equity”) in the property after repaying the mortgage lender to satisfy the association’s debts.

**Figure 26: Priority of charges**

<table>
<thead>
<tr>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>A unit owner buys a commonhold unit for £120,000. A mortgage lender loans the unit owner £110,000 to purchase the property. To protect its interest, the lender secures a charge over the unit in the amount of £110,000. There is a downturn in the property market and the property is now worth £100,000. The unit owner stops paying his or her share of the commonhold contributions. If the association is granted a charge ranking below the mortgage, it would not be worthwhile for the association to seek an order forcing the sale of the property. The mortgage lender would be repaid the entire £100,000 out of the proceeds of sale (minus certain deductions for the cost of arranging the sale), leaving nothing for the unit owner and the commonhold association.</td>
</tr>
</tbody>
</table>

14.51 Whilst at first glance, providing the commonhold association with a charge which takes priority over first legal mortgages may appear unattractive to lenders, enhancing the association’s enforcement powers is also in the interests of lenders. As the Aldridge Report explained:

non-payment of service charges undermines the [mortgage lender’s] security … it is possible that they will have several loans secured on different units within the same development. Any disadvantage in having their interest postponed to a lien [charge] on one unit is offset by the additional protection which they have in relation to other units, through an efficient system of obtaining payment of service charges. It also gives more protection than that enjoyed by the [mortgage lender] of a lease whose interest is terminated where a landlord forfeits the lease on breach of covenant by the lessee.\textsuperscript{97}

\textsuperscript{96} The unit owner him or herself may apply for bankruptcy or another creditor may file a bankruptcy petition.

\textsuperscript{97} Aldridge Report, para 9.28.
14.52 Mortgage lenders responding to our Call for Evidence agreed that the lack of forfeiture within commonhold could, in some respects, improve the security currently available over leasehold interests. Where leases are terminated on forfeiture, lenders will also lose their security. Whilst there is an obligation for landlords to notify mortgage lenders if they intend to forfeit, this does not always happen in practice and can cause significant inconvenience, as one consultee explains:

the Society is seeing an increase in forfeiture proceedings without any prior warning being given to it which increases the risk to its security. In some cases the forfeiture action has already been successful which means a lender like us has lost its security and has to obtain relief from forfeiture in order to reinstate its security. The costs which have to be paid by a lender, (which invariably include the use of specialist external lawyers) to ensure that relief from forfeiture is obtained and its security reinstated, can be significant and those costs are added to the borrower’s mortgage debt with the consequent erosion of equity which such payment entails.99

Protection for defaulting owners

14.53 We identified above, however, that strengthening the commonhold association's enforcement powers should not lead to excessive or disproportionate penalties being imposed on individual unit owners. We do not think that imposing a charge over the commonhold units, enforceable by sale of the property, would automatically be an excessive or disproportionate remedy. Sale of commonhold units would not result in owners being deprived of any value they had invested in the property.

14.54 However, the way in which the commonhold association may be able to exercise the power of sale, and any associated powers, merits close scrutiny. The power of sale should be a remedy of last resort with sufficient safeguards in place to protect defaulting unit owners faced with losing their homes.

14.55 Previous proposals for commonhold envisaged that a commonhold association should be able to enforce the charge in the same way as a first legal mortgage lender.100 A number of academics, and some respondents to our Call for Evidence, argue that the 2002 Act should have followed suit.101

14.56 Having carefully considered the powers available to mortgage lenders with the benefit of a legal charge, we do not think it would be appropriate to place the commonhold association in exactly the same position. We make the following observations.

98 Civil Procedure Rules, Practice Direction 55A, para 2.4.
99 See Commonhold: A Call for Evidence – Analysis of Responses, para 7.7.
100 By "first" we mean that the charge will take priority over all other charges as discussed in para 14.50 above. By "legal" we mean that the charge has been created by deed and has been registered at HM Land Registry, declaring the land to be charged by way of a legal mortgage. Where these formalities have not been met, the mortgage lender may still be entitled to an "equitable mortgage". However, owners of equitable mortgages often do not have the same powers as legal mortgage lenders.
In certain instances a mortgage lender may be able to arrange the sale of a property without having first obtained a court order.\(^\text{102}\) We think it should always be necessary for a commonhold association to obtain a court order before a commonhold unit may be sold. We consider that unit owners should always have the option of presenting their case at court and should have their particular circumstances taken into account. Unit owners should also be given every opportunity to reach an acceptable payment arrangement in order to avoid their property being sold. Such payment arrangements are often facilitated by the court. The court will also provide an important safeguard in ensuring that the debt is due and payable under the terms of the CCS. Further, if the commonhold association could sell a unit owner’s property without the safety net of a court order, there is a concern this could lead to victimisation of certain unit owners.

In addition, a mortgage lender will be able to arrange the sale of a property personally (or through an agent). We do not think it would be appropriate to allow the commonhold association to arrange the sale of the unit owner’s property. The commonhold association is not a trading company that can be expected to have experience of the property market. Additionally, its members are the neighbours of the unit owner who is in default. We are particularly conscious of the social dynamic within commonhold, which will involve people living in close proximity. We are mindful not to introduce provisions which could enflame disputes or make life unnecessarily difficult for certain unit owners.\(^\text{103}\) Those concerns are particularly acute when a unit owner may be vulnerable as a result of financial difficulty. We therefore consider it more appropriate for a third-party receiver\(^\text{104}\) to be appointed to arrange the sale of the defaulting unit owner’s property. The receiver, as an independent party, would be best placed to arrange a sale and distribute assets fairly, given the numerous parties who would have an interest in the property: the unit owner, the association and any mortgage lenders.

The powers of a commonhold association will not be subject to any external regulation. Most mortgage lenders, as financial services providers, are subject to significant regulation. The regulation places limitations on the powers available to lenders where the borrower is in default,\(^\text{106}\) for example, to ensure that the

\(^{102}\) See for example *Ropaigealach v Barclays Bank plc* [2000] QB 263.

\(^{103}\) Two consultees to our Call for Evidence explained that, in leaseholder owned companies, there is already a reluctance to take direct legal proceedings against neighbours for non-payment.

\(^{104}\) The term “third-party receiver” is usually used to refer to an independent person appointed, for instance, to manage a person or company’s affairs, or for the collection or protection of property.

\(^{105}\) Requiring a receiver to carry out the sale would also reflect the Commission’s recommendations in its report *Termination of Tenancies for Tenant Default* (2006) Law Com No 303. In this report, the Commission recommended abolishing the landlord’s remedy of forfeiture of residential leases. Instead, the landlord would be able to apply to court for an appropriate remedy. The court would have various powers at its disposal, including a power to order the sale of the leasehold interest. In making an order for sale, the court would be required to appoint a receiver to conduct the sale and distribute the proceeds. The appointment of a receiver was deemed appropriate given “the range of circumstances in which an order for sale may be appropriate, and the number of different interests which may be involved”: para 5.64.

\(^{106}\) Regulation is provided, in particular, by the Mortgages and Home Finance: Conduct of Business Sourcebook ("MCOB") maintained by the Financial Conduct Authority. Possession is dealt with in MCOB 13. MCOB applies to regulated mortgage contracts, which includes most first legal mortgages.
borrower is given every opportunity to pay and make the sale of the property a matter of last resort. The lender is also under a duty to "obtain the best price that might reasonably be paid" when selling the property.\textsuperscript{107} This body of protection and regulation would not apply where a commonhold association sought to sell a property. We would not wish to create a situation in which the body of protection available to mortgage lenders is completely undermined by a commonhold association enforcing the sale of a unit.

(4) Some respondents to our Call for Evidence suggested that the association should have the same power as a mortgage lender to enter into possession (or, in other words, take control) of the property in order to collect rental income from any tenant. However, as explained above, there is already a power available to divert rent from unit owners’ tenants to the association, so this additional power should not be necessary.

14.57 Instead, we propose that a different regime, incorporating additional safeguards, should apply where the unit owner fails to pay their share of the commonhold contributions:

Enforcement of the charge in commonhold

14.58 We provisionally propose that a charge over a commonhold unit should only be enforceable in the following way.

(1) The commonhold association should be required to follow a specific pre-action protocol. The protocol would set out the steps to be complied with before the association could take further action. These steps would include a requirement to provide information to the defaulting unit owner and make reasonable attempts to agree a repayment plan with the unit owner.

(2) If the parties are unable to reach an agreement for the repayment of arrears after following the pre-action protocol, the commonhold association would be able to apply to court for an order for sale. Before doing so, the association would need to notify any other individuals who have an interest secured against the property (such as mortgage lenders).

(3) In order for the regime to be proportionate, the court would only be able to grant the order for sale if the outstanding sums exceed a certain amount. This figure could be set by Government and would be included within the CCS. Unit owners would therefore be reassured that they would not risk losing their property as a result of a minor breach of the CCS.

(4) Before deciding whether to grant an order for sale, the court would first check that the sums in question have been properly demanded and are due. Unlike long leaseholders, unit owners will not have a right to challenge the reasonableness of costs after they have been incurred (although we are proposing a new pre-emptive right – see Chapter 10).\textsuperscript{108} However, the sums will need to have been demanded in accordance with the provisions of the CCS in order to obtain a remedy. The court would also take into account the extent to which the pre-action

\textsuperscript{107} MCOB 13.6.1.
\textsuperscript{108} A long lease is a lease that is granted for a term of more than 21 years.
protocol has been complied with and ensure that any mortgage lender has been notified of the claim.

(5) The court would then proceed to weigh up the competing interests of the defaulting unit owner and the other unit owners as members of the commonhold association. In particular, the court should take into account the impact of the breach on the other unit owners (for instance, whether they are effectively subsidising the defaulting owner) and the risk of the commonhold association becoming insolvent. The court would also consider the protections available if the mortgage lender had been applying for an order of sale.

(6) Following these steps, the court would be able to order the sale of the unit, refuse to make the sale or postpone the sale for a certain period, provided that the unit owner makes certain payments by set dates.

(7) If the court decides to order the sale of the unit, the court should appoint a receiver to arrange the sale of the unit and distribute the proceeds. The order of distribution would be as follows.

(a) The receiver should be paid his or her costs of arranging the sale of the property.

(b) The commonhold association would be repaid any outstanding amounts of commonhold contributions. The association would also be entitled to any interest payable on the outstanding amounts under the terms of the CCS and any costs awarded by the court.

(c) The proceeds of sale would then be used to repay any other party who has an interest secured against the unit, such as a mortgage lender.

(d) Any remaining amount should then be returned to the defaulting unit owner.

(8) Any tenancies granted out of the unit (and any sub-tenancies granted out of those tenancies) should continue to exist following the order for sale. The purchaser of the unit following the order for sale would take ownership of the unit subject to any existing tenancies.\(^{109}\)

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\(^{109}\) This reflects our proposals in our report, Termination of Tenancies for Tenant Default (2006) Law Com No 303. The report states that an order for the sale of the lease would not terminate the leasehold interest: the leasehold interest would continue, albeit in the hands of the purchaser. The sale would be subject to any interest deriving from the lease such as a sub-tenancy: para 5.62.
Consultation Question 85.

14.59 We provisionally propose that a commonhold association should have an automatic statutory charge over commonhold units for the payment of commonhold costs.

Do consultees agree?

14.60 We provisionally propose that if the commonhold association has an automatic statutory charge over commonhold units for the payment of commonhold contributions, this charge should take priority over all other charges (such as a mortgage over the property).

Do consultees agree?
**Consultation Question 86.**

14.61 We provisionally propose that, before taking action to enforce a charge over a commonhold unit, the commonhold association should be required to follow a pre-action protocol. We envisage that the protocol will require the association to provide prescribed information to the defaulting unit owner and make reasonable attempts to agree a repayment plan.

Do consultees agree?

14.62 We invite consultees’ views as to what steps the association should be required to take as part of this protocol.

14.63 We provisionally propose that where the commonhold association wishes to enforce a charge over a commonhold unit by selling the unit, it should always be necessary for the association to apply to court for an order for sale.

Do consultees agree?

14.64 We provisionally propose that the court should only be able to order the sale of a unit where the amount owing to the commonhold association exceeds a certain amount.

Do consultees agree?

14.65 We invite consultees’ views as to what this amount should be and on what factors the court should take into account when deciding whether to order the sale of a unit.

14.66 We provisionally propose that where the sale of a unit is ordered, the court should appoint a receiver to sell the unit and distribute the proceeds of sale.

Do consultees agree?

14.67 We provisionally propose that where a receiver is appointed to sell a commonhold unit, the receiver should distribute the proceeds of sale in the following way.

(1) The receiver should be paid his or her costs of arranging the sale of the property.

(2) The commonhold association should be repaid any outstanding amounts of commonhold contributions, plus any interest and costs awarded by the court.

(3) Any other party who has an interest secured against the unit, such as a mortgage lender, should be repaid.

(4) Any remaining amount should then be returned to the defaulting unit owner.

Do consultees agree?

14.68 We provisionally propose that any tenancies granted out of a unit should continue to exist following an order for sale.

Do consultees agree?
Part VII: Termination of a commonhold
Chapter 15: Voluntary termination of commonholds

INTRODUCTION

15.1 Any building will have a finite life, unless it is preserved for architectural or historic reasons. It may be desirable to redevelop a building in a number of circumstances, such as the following examples.

(1) A building may be redeveloped where it is no longer economically viable to repair the building. This situation might arise where, for example, the building has been substantially destroyed by fire, or where the building has reached the stage of its life where substantial repair is uneconomic.

(2) In other cases, a building may be redeveloped where changes in the character of the area mean that the land on which it stands has become more valuable, and capable of offering a higher economic return. This situation could arise even where it would still be viable to repair the building. For example, a residential building may be situated in an area where commercial use is now more appropriate, or vice versa.

15.2 Despite the likelihood of buildings needing to be redeveloped, the law makes no provision for the redevelopment of buildings divided into separate leasehold flats. Redevelopment therefore tends to take place in an ad-hoc way which can disadvantage the leaseholders. For example, an investor or developer may buy up the leases of the flats one by one, until the remaining leaseholders feel pressured to sell.

15.3 Commonhold provides an opportunity to deal with redevelopment in a more structured manner, giving decision-making control to the owners of the flats. In this chapter, we explore the circumstances in which it should be possible for unit owners to bring a commonhold to an end. In particular, we consider what percentage of unit owners should be required to support the decision to terminate and, if unanimity is not required, what safeguards should be put in place to protect the minority. We also consider what safeguards should be put in place to protect mortgage lenders’ interests on the termination of a commonhold.

THE CURRENT LAW

15.4 It is possible for a commonhold to be terminated if it has been registered in error because the formality requirements have not been followed. It may also be terminated during the transitional period between registration and the sale of the first unit if the applicant decides not to go through with the development, either as a commonhold, or at all. A commonhold must also be terminated if the entire commonhold is compulsorily

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1 CLRA 2002, s 6(1).
2 CLRA 2002, s 8(4).
We are not aware of any suggestions from commentators that the way in which the 2002 Act deals with these matters is unsatisfactory. No respondents to our Call for Evidence raised these matters. We therefore confine ourselves to issues that have been raised in connection with the voluntary termination of a commonhold.

15.5 Voluntary termination arises where a commonhold has been set up, but the unit owners decide that they want the entire commonhold to be sold and the proceeds of sale divided between themselves.

15.6 It is appropriate at the outset to distinguish voluntary termination of the commonhold, which we deal with in this chapter, from the insolvency of the commonhold, which we deal with in Chapter 7, particularly from paragraph 7.43 onwards. There are some similarities: in both cases a liquidator would be appointed; and in both cases the process would be under the supervision of the court. There are, however, two important distinctions.

(1) Termination is likely to take place when the commonhold association is fully solvent.

(2) With insolvency, it is the assets of the commonhold association which come under the control of the liquidator, and need to be distributed. With voluntary termination, in addition to the assets of the association, the units belonging to the individual unit owners also come under the control of the liquidator.

15.7 The commonhold association is a company limited by guarantee, registered at Companies House under the Companies Act. The starting point therefore is that the provisions of the Insolvency Act 1986 apply when the unit owners—as the members of the association—decide to terminate it. The termination will be a members’ voluntary winding up, so the appropriate provisions of the Insolvency Act will apply to it. It should be noted that, although winding up is governed by the Insolvency Act 1986 and the Insolvency Rules 2016, members may wind up a company on a voluntary basis only if it is, in fact solvent, that is, the total assets that it owns exceed its debts and other liabilities. The key stages of the voluntary termination process are set out below, and shown in figure 27 below.

Declaration of solvency

15.8 The directors must make a statutory declaration that the commonhold association is solvent. Before making the declaration the directors must make a full enquiry into the company’s affairs and form an opinion that the company will be able to pay its debts in

3 CLRA 2002, s 60. It is understood that it was intended that regulations would be made to supplement the provisions of the CLRA 2002 on this matter, but no such regulations have been made.

4 We are recommending that this should remain a matter for the court, and that the Insolvency Court would be the court with the most appropriate expertise.

5 The main provisions in relation to members’ voluntary winding up are set out in chs 2 to 5 of part 4 of the Insolvency Act 1986. These provisions are supplemented by other provisions of the Act, and the Insolvency (England and Wales) Rules 2016, SI 2016 No 1024.

6 This is required by the CLRA 2002, s 43(1)(a), and is in accordance with the Insolvency Act 1986, s 89.
full, together with interest, within 12 months of the winding-up resolution. The declaration of solvency must be made at least five weeks before the winding-up resolution (see paragraph 15.11 below).

Termination-statement resolution

15.9 The commonhold association must pass a resolution approving the terms of the termination statement. The termination statement must include proposals for the transfer of the commonhold land, and the distribution of assets on termination, as on termination the units will vest in the commonhold association. The statement must comply with any requirements set out in the commonhold community statement (“CCS”). At least 80% of the available votes must approve the terms of this statement.

15.10 The current law does not require the termination statement to make provision for the position of any tenants of unit owners on termination.

Winding-up resolution

15.11 The commonhold association must pass a resolution winding up the commonhold association. At least 80% of the available votes must be in favour of this resolution.

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7 Or any shorter period specified: Insolvency Act 1986, s 89. If a director makes a statutory declaration of solvency without having reasonable grounds for the opinion that the company will be able to pay its debts in full he or she may be liable for imprisonment or a fine, or both (Insolvency Act 1986 s 89(4)). The declaration must also include a statement of the company’s assets and liabilities (Insolvency Act 1986, s 89(2)(b)). The official rate of interest is the higher of the contractual interest or the current rate under the Judgments Act 1838 (Insolvency Act 1986, s 189(4)).

8 Insolvency Act 1986, s 89(2).

9 CLRA 2002, s 43(1)(b).

10 CLRA 2002, s 47(1).

11 CLRA 2002, s 47(3). A member of the commonhold association may however apply to court to disapply any requirement of the CCS relating to the termination statement (s 47(4) and (5)). G Cowen, J Driscoll and L Target, Commonhold Law and Practice (2005 1st ed) para 14.2.2 refers to the CML handbook which requires the conveyancer acting for the lender to ensure the CCS provides that in the event of voluntary termination of a commonhold, the termination statement provides that the unit owners will ensure that any mortgages secured on their units are repaid. This is discussed later at paras 15.64 to 15.72.

12 CLRA 2002, s 43(1)(c). If all unit owners have an equal vote, this is 80% of all the unit owners, but, if votes are “weighted”, say, in favour of large units, then it is the total number of votes available which is relevant.

13 CLRA 2002, s43(1)(b). CLRA 2002, s 43 refers to the winding-up resolution as being “a resolution for voluntary winding-up within the meaning of section 84 of [the Insolvency Act]”. Section 84(2A) and (2B) requires five days’ written notice to be provided to the owners of certain floating charges before passing the winding up resolution. However, s 84(4) of the Insolvency Act 1986 refers back to the commonhold legislation stating “this section has effect subject to s 43 of CLRA 2002” It is therefore unclear whether notice is in fact required to be provided to floating charge holders.

14 CLRA 2002, s 43(1)(c). Additionally, the resolution must be advertised in the London Gazette (Insolvency Act 1986, s 85(1)), and the declaration of solvency must be lodged at Companies House (Insolvency Act 1986, s 89(3)).
Appointment of a liquidator

15.12 A liquidator must be appointed for the purpose of winding up the commonhold association’s affairs and distributing its assets. A liquidator must be a licensed insolvency practitioner. When the liquidator is appointed all the powers of the directors will end, unless the liquidator or the commonhold association authorise these powers to continue.

15.13 If the liquidator forms an opinion that the commonhold association will be unable to pay its debts within the period of time set out in the termination statement, the creditors of the association will be provided with an opportunity to nominate their own liquidator. The liquidation will subsequently proceed as if it had been commenced as a creditors’ winding up, which is the procedure applicable where a company is insolvent. This procedure is consistent with what would apply in the case of any private company that the members resolved to wind up voluntarily, and which then turned out to be insolvent. There are, however, considerable doubts as to how far this switch of procedure can appropriately be applied to a commonhold association. These will be discussed in paragraphs 15.73 to 15.79 and 15.124 to 15.125.

15.14 The next stages vary depending upon whether the termination statement and winding up resolutions receive unanimous support.

100% support for termination

Termination application

15.15 Where 100% of the members of the commonhold association vote in favour of both the resolution approving the termination statement and the resolution to wind up the commonhold, the liquidator must make a termination application within six months of the winding-up resolution. The application must be accompanied by the termination

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15 Insolvency Act 1986, s 91(1) provides for the appointment of a liquidator or joint liquidators by the company (in this instance the commonhold association) in a general meeting. For the purposes of this Consultation Paper, it is assumed for convenience that a sole liquidator is appointed.

16 The liquidator must ensure that winding up is carried out strictly in accordance with the statutory rules of priority etc. The title “insolvency practitioner” does not necessary imply that the company is insolvent.

17 Insolvency Act 1986, s 91(2).

18 CLRA 2002, s 48 refers to a liquidator as being either a liquidator appointed under section 91 of the Insolvency Act by the company in a general meeting or “in the case of a member’s voluntary winding up which becomes a creditors’ voluntary winding up by virtue of sections 95 and 96 of that Act, the person acting as liquidator in accordance with section 100 of that Act.” It is possible, however, that the reference here should be to section 95(4B).

19 CLRA 2002, s 48(7)(b).

20 Insolvency Act 1986, s 96(1). It does not appear possible for the termination process to be commenced under the creditor’s voluntary winding up procedure. Rather, the members’ voluntary procedure can turn into creditors’ voluntary winding up procedure subsequently if the liquidator forms the opinion that the commonhold association cannot pay its debts.

21 CLRA 2002, s 44(2).
If the liquidator fails to make a termination application within the prescribed time-limits, a unit owner may apply instead. If the liquidator fails to make a termination application within the prescribed time-limits, a unit owner may apply instead.

15.16 The liquidator must notify HM Land Registry of his or her appointment.

15.17 The next stages vary depending upon whether the liquidator is satisfied with the termination statement prepared by the directors.

Liquidator satisfied with termination statement

Termination

15.18 If the liquidator is content with the termination statement, then he or she must notify HM Land Registry that this is the case as soon as possible. The commonhold association will then be entitled to be registered as the owner of the commonhold units in addition to the common parts. The Registrar will take any action necessary to give effect to the termination statement.

Liquidator not satisfied with termination statement

Court application

15.19 If the liquidator is not content with the termination statement, he or she must first apply to court to determine the terms of the termination statement as soon as possible. It is therefore possible for the members unanimously to agree that they wish the commonhold to be terminated, and to agree on the terms of the termination, but for the court to reject their termination statement. The termination would then proceed on the terms set by the court. There would appear to be no provision for the members to have second thoughts and to resile from their previous decision to terminate the commonhold.

Termination

15.20 Once the court has determined the terms of the termination statement, the liquidator must send a copy of it to HM Land Registry as soon as possible. The commonhold association will then be entitled to be registered as the owner of all of the commonhold units in addition to the common parts. The Registrar will take any action necessary to give effect to the termination statement. It is very unlikely that, at this stage, the Registrar will be able to consolidate the titles to the common parts and to the units so that they form a single title at HM Land Registry. In most cases there will be legal

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CLRA 2002 s 46(2).
CLRA 2002, ss 44(2) and 45(4).
CLRA 2002, s 48(2).
CLRA 2002, s 48(3)(a) and (6).
CLRA 2002, s 49(1)(a).
CLRA 2002, s 49(4).
CLRA 2002, ss 48(3)(b) (under s 112 of the Insolvency Act) and 48(6).
CLRA 2002, s 49(1)(b).
CLRA 2002, s 49(4).
charges (mortgages), and perhaps charging orders, registered against the titles to the individual units. The units will therefore remain as separate titles, but all registered in the name of the commonhold association. By this stage, the association will be under the control of the liquidator.

**Less than 100% support for termination**

**Court application**

15.21 An application to the court will be required unless both the termination statement and winding up resolutions received the support of 100% of the members of the commonhold association. The liquidator must apply to court within three months of his or her appointment for an order approving the terms of the termination statement and the terms on which a termination application (see below) may be made. If the liquidator fails to make an application to court within this period, a unit owner may make this application on the liquidator’s behalf.

**Termination application**

15.22 A termination application is an application to HM Land Registry to end the commonhold. The application must be accompanied by the termination statement. This application must be made by the liquidator within three months of the court order. The liquidator must also notify HM Land Registry of his or her appointment. If the liquidator fails to make an application to court within the three-month period, a unit owner may make this application on the liquidator’s behalf.

**Termination**

15.23 The commonhold association will be entitled to be registered as the owner of the commonhold units in addition to the common parts and the matter will proceed as outlined at 15.20 above.

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31 CLRA 2002, s 44(1) and (2).
32 Commonhold Regulations 2004, Part 6, r 19(1); CLRA 2002, s 45(2).
33 CLRA 2002, s 45(4).
34 CLRA 2002, s 46(1); “A termination application” is an application to the Registrar that all the land in relation to which a particular commonhold association exercises functions should cease to be commonhold land.” The application should be on prescribed form CM5(1) (Commonhold (Land Registration) Rules 2004 r 21(1)).
35 CLRA 2002, s 46(2).
36 See para 15.21; CLRA 2002, s 45(3).
37 CLRA 2002, s 48(2).
38 CLRA 2002, s 45(4).
39 CLRA 2002, s 49(2).
Winding-up the commonhold association

15.24 Following the vesting of the commonhold units in the commonhold association, the next stage is for the liquidator to actually wind up the commonhold: which, in the case of a voluntary termination, also includes the value of the units. A declaration of solvency will have been made by the directors at the outset (see paragraph 15.8) and initially accepted by the liquidator (see paragraph 15.13 above), so it is unlikely that the commonhold will turn out to be insolvent. So long as the commonhold is, in fact, solvent the winding up continues in accordance with the members’ voluntary winding up procedure generally applicable to companies. If further details come to light which lead the liquidator to form the view that the commonhold is, in fact, insolvent, then the winding up could proceed as a creditors’ voluntary winding up. As previously noted (see paragraph 15.13 above), it is unclear what the full implications of this approach would be in the context of a commonhold. This matter is discussed further at paragraphs (to paragraphs 15.73 to 15.79 and 15.124 to 15.125).

15.25 In the case of a voluntary termination by the members, the likely principal task of the liquidator is to oversee the sale of the commonhold site. It is likely that the units and common parts, though remaining as separate titles at HM Land Registry, will be sold as a single site. If the commonhold is being terminated because an attractive offer has been made for redevelopment, then it is likely that a prospective buyer will already be in place. If the commonhold is being terminated because, say, it is beyond economic repair, then the liquidator will have to arrange for the commonhold site to be marketed. It is possible that the site may realise more or less than was originally estimated.

15.26 The liquidator in a voluntary termination will, of course, also have to wind up the commonhold association in all other respects, including:

1. getting in, so far as possible, any debts owed to the association by non-unit owners;
2. getting in any arrears of commonhold contributions owed by unit owners;
3. ascertaining the debts owed by the association, whether secured or unsecured; and
4. ascertaining the amounts required to clear mortgages or other charges registered against individual units.

15.27 The amount standing in the general account for contributions to shared costs, and the amount standing in any reserve fund or funds, would also be available to the liquidator.

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40 Including, in this context, both the commonhold association, and the value represented by the units and the common parts.

41 In practice arrears may simply be agreed to be deducted (with interest) from the final payment to be made to each unit owner.
15.28 From the proceeds of sale, the liquidator will make the following payments in order of priority:

(1) his or her own expenses;"42

(2) payments to discharge debts that have been secured against the commonhold land or assets, for instance a mortgage over a unit;

(3) “preferential debts” which take priority, to a certain extent, over other debts of the association."43 Preferential debts are set out in schedule 6 of the Insolvency Act 1986 and include remuneration of employees;

(4) unsecured debts, for instance, outstanding payment for works by a contractor. If the assets of the commonhold were not sufficient to pay all the unsecured debts, the unsecured creditors share the sums available in proportion to the debts due to them."44 As previously noted, it is unlikely that this scenario would arise in the context of a voluntary termination. The issues raised in the event that it does are discussed at paragraphs 15.73 to 15.79 and 15.124 to 15.125 below);

(5) any remaining sums are then shared between the members of the company (the unit owners) according to the termination statement."45

15.29 If during either procedure there is no liquidator available to act, for whatever reason, the court has power to appoint a liquidator."46

15.30 The liquidator or any creditor may apply to court to determine any question arising in the winding up of a company or to ask the court to exercise a particular power."47

15.31 The liquidator has a duty to provide progress reports to the company."48 The liquidator must also provide an account showing how the winding-up has been conducted and what has been done with the company’s property."49

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42 Insolvency Act 1986 s 115: “all expenses properly incurred in the winding up, including the remuneration of the liquidator, are payable out of the company’s assets in priority to all other claims.” It is not beyond doubt that the liquidator would take in priority, as, if the lender conducted the sale, he or she would repay his or her debt in full, and account the liquidator for the balance.

43 Insolvency Act 1986, s 175.

44 Insolvency Act 1986, s 107. The sums paid to unit owners will likely take into account any mortgages a unit owner had over their unit and any debts due by that unit owner to the association eg contributions to shared costs or for damage caused by that unit owner. A unit owner who had a £60,000 loan over their unit and owed the commonhold association £1000 would therefore receive less than someone who had no mortgage and was up to date with commonhold contributions.


46 Insolvency Act 1986, s 107.

47 Insolvency Act 1986, s 112(1).

48 Insolvency Act 1986, s 92A, in the members’ voluntary winding up procedure and s 104A in the creditors’ voluntary winding up procedure.

49 Insolvency Act 1986, s 94 in the members’ voluntary winding up procedure and s 106 in the creditors’ voluntary winding up procedure. The account needs to be provided to the members of the commonhold
15.32 The company will be dissolved after three months of the registrar of companies receiving and registering the liquidator's final account showing how the company has been wound-up.50

The termination statement

15.33 The termination statement will have to deal with practical matters such as when unit owners and their tenants will have to vacate their units, and other points of detail. However, the most important issue for the termination statement to address will be the division of the proceeds of sale of the commonhold site.

15.34 The current law provides that the CCS may determine in advance how the proceeds of sale should be divided, in the event that the commonhold is terminated.51 It is not, however, compulsory for it to do so. Any such provision would therefore have to be by the making of local rules.52 If the CCS does make such advance provision, the termination statement must comply with it,53 though it is possible for any member of the commonhold association to apply to the court for the advance provision to be disapplied, either in whole or in part.54

50 Insolvency Act 1985, s 201.
51 CLRA 2002, s 47(2).
52 A local rule is a provision in the CCS which is specific to that particular commonhold, rather than one which is required by law to apply to all commonholds.
53 CLRA 2002, s 47(3).
54 CLRA 2002, s 47(4) and (5).
Figure 27: The current voluntary termination procedure

Directors make declaration of solvency

- Termination statement and winding up approved by resolution
  - Approved by 100% of available votes
  - Approved by more than 80% but less than 100% of available votes
  - Liquidator appointed

- Liquidator notifies HM Land Registry of appointment and makes termination application to HM Land Registry within six months of winding up resolution

  - Liquidator satisfied with termination statement?
    - Yes: Liquidator notifies HM Land Registry
    - No: Liquidator applies to court to determine terms of termination
      - Liquidator sends copy of termination statement to HM Land Registry

- Liquidator does not make termination application to HM Land Registry within six months of winding up resolution

  - Within 3 months, liquidator applies to court for order approving termination statement and terms of termination
    - A unit owner may apply to court for order approving termination statement and terms of termination
      - Court approves termination statement and settles terms of termination
        - Within 3 months of court order, liquidator does not make termination application
          - Within 3 months of court order, termination application made by liquidator

HM Land Registry takes any action necessary to give effect to termination statement
Conversion of a voluntary termination into a creditors’ voluntary winding up

15.35 The 2002 Act provides for the possibility that a voluntary termination may have to be converted into a creditors’ voluntary winding up, in the unlikely event that it turns out that the directors’ declaration of solvency was incorrect.55 The implications of this are discussed below.

CRITICISMS OF THE CURRENT LAW

15.36 None of the commonholds that have been created to date have been terminated under the voluntary termination procedure. Therefore, there is no direct evidence of problems with the existing law. However, in response to our Call for Evidence, UK Finance suggested that there was concern among their members as to the status of their security if the commonhold was terminated. Professor James Driscoll56 also identified uncertainty on the part of lenders as to their position on termination as one of the factors that had prevented the take up of commonhold. Several other respondents expressed concern as to the position of lenders on voluntary termination, although one57 suggested that concerns were expressed but not substantiated.

15.37 Concerns as to the position of lenders on voluntary termination risk undermining confidence in commonhold. We therefore take the view that our review should be used to clarify the position of lenders.

15.38 Most respondents to the Call for Evidence thought that it was appropriate that it should be possible for a commonhold to be terminated if the proposal were supported by a suitably high majority of unit owners. However, at least one respondent stressed that commonhold was intended to provide for freehold ownership of flats. He said it was therefore wrong in principle that, as a result of the termination provisions, a unit owner could lose his or her units on the basis of the wishes of an 80% majority of unit owners.58 He further suggested that this risk made commonhold less secure than leasehold. Other commentators have made a similar point.59

15.39 The broad questions raised in our Call for Evidence were whether it should be possible to terminate a commonhold with less than unanimous support, and whether mortgage lenders are adequately protected on termination. In considering the position on termination, however, some further points have also come to our attention. In this chapter we therefore consider the following points:

1. the general policy question of whether it should be possible to terminate a commonhold with less than unanimous support;

2. if so, what an appropriate majority should be;

55 CLRA 2002, s 48(7)(b).
56 A retired academic who has written on commonhold and who is also a former judge in the First-tier Tribunal (Property Chamber).
57 Mr Laurence Target.
58 Mr Martin Wood (former senior lawyer with HM Land Registry, and a member of the Aldridge Report Working Group).
59 M Dowden, “Very little appetite for a change in tenure” (2009) 0917 Estates Gazette 98: “in reality, a commonhold unit might be lost to a forced sale within a shorter period than a lease.”
(3) what further safeguards, if any, should be required, including the role actually to be played by the court;

(4) the position of mortgage lenders, and, in particular, how their security should best be protected on termination;

(5) whether the shares each owner should receive on termination should be set out in advance in the CCS, or whether it is best left to be decided if and when termination occurs; and

(6) the interrelationship between voluntary termination and winding up on insolvency if the declaration of solvency turns out to be inaccurate and the termination has to become a creditors’ winding up.

The principle of providing for termination

15.40 It is unobjectionable that all unit owners should be able to terminate the commonhold by unanimous agreement, provided that the interests of mortgage lenders and other secured lenders are protected. Any provision that permits a unit owner to be deprived of their unit without their consent, however, raises serious policy issues as regards the position of those who do not agree to the termination.

15.41 The sale of a commonhold unit against the wishes of the owner may raise issues under the Human Rights Act 1998. In particular, the loss of what will often be someone’s home will engage Article 8 of the European Convention of Human Rights, and the potential loss of property will engage Article 1 of the First Protocol to the Convention. These rights are not absolute, however; whether there is an infringement is ultimately dependent on whether the extent of the interference is justified by a legitimate aim pursued in doing so.

15.42 Provision for voluntary termination is a common feature in common law jurisdictions which have strata title or condominium legislation. Those jurisdictions that did not provide for voluntary termination originally have done so when revising and updating their original legislation.

15.43 If it should be possible to terminate a commonhold with less than unanimous support, then we need to consider:

(1) what the appropriate level of support should be; and

(2) what other safeguards should be included to protect the minority.

60 “Everyone has the right to respect for his private and family life, his home and his correspondence.”

61 “Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”
The level of support required for voluntary termination

15.44 Throughout the development of commonhold, a consistent stance has been taken on the level of support which should be required to justify the voluntary termination of the commonhold. In the absence of unanimity, the view has been maintained that a decision to terminate should require the support of 80% of the available votes,62 plus the sanction of the Court. This principle is reflected in the 2002 Act.

15.45 Other common law jurisdictions seem to require a broadly similar level of support for the termination of a commonhold, if the decision to terminate has less than unanimous support. For example, New South Wales and British Columbia enable voluntary termination with 75% and 80% support (respectively) plus court approval. In New Zealand, 75% support is required without the need for court approval. There does, therefore, seem to be a broad consensus that provision for voluntary termination is desirable, and also a consensus as to the level of support that should be required (if unanimity cannot be achieved).

15.46 Once it is accepted that it should be possible to terminate a commonhold with less than unanimous support, then it seems to us that the level of support that should be required should be at the upper level of what is required within the commonhold provisions. It should be noted that the current level of support (80% of the available votes) is in practice considerably higher than what is required to pass a special resolution, as that might be passed by 75% of the votes cast by those who were present at a meeting, and voted. Our provisional view, in light of the absence of experience of the use of voluntary termination is that the threshold should be left at 80% of the available votes.

The position of tenants

15.47 We have considered the position of tenants of units, and have taken the provisional view that it is not necessary for separate provision to be made for them. Private “buy-to-let” landlords of units are likely to consent to termination so that it takes effect at the end of an assured shorthold tenancy. Registered providers of social housing, who own units and wish to consent, are likely to do so on the basis that they can offer alternative accommodation to their tenants.63 It is possible that a unit may be let on a business tenancy which enjoys protection.64 If so, an intention to demolish or reconstruct the building at the end of the lease would entitle the landlord to refuse to renew it. It might well be necessary to enact that, if a statute required that a landlord had to prove an intention to demolish or reconstruct the building, this would also be satisfied if the commonhold association had that intention.

Other safeguards that might be included to protect the minority

15.48 Prior to the 2002 Act it was suggested that, following a vote of at least 80% in favour, a resolution in favour would then require the approval of the court. This approach envisaged that the court would have the power to exercise discretion, and would

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62 It should be noted that more votes may be allocated to some units than to others, and that those who own more than one unit will be able to exercise the full number of votes for each of them.

63 By “registered provider of social housing” we mean, in England, those providers which are regulated under the Housing and Regeneration Act 2008. The equivalent term in Wales is “registered social landlord”.

64 Under the Landlord and Tenant Act 1954, Pt II.
conduct some form of balancing test, although no guidance was offered on how the court might exercise this discretion, or the factors to be taken into account.

15.49 The 2002 Act, on the other hand, takes a more restrictive approach. It says that if a termination resolution and termination statement are passed with at least 80% support, the liquidator is required to apply to the court. The court must then determine the terms and conditions upon which a termination application might be made to HM Land Registry, and the terms of the termination statement. The scope of this provision has never been tested in court, but it appears that the role of the court is limited to settling the terms of the termination statement, and imposing further terms and conditions, if it saw fit. The court would not, apparently, have the power to decide that the termination should not proceed.

15.50 The court might, it seems, attempt to protect the interests of the dissenting minority by imposing such terms and conditions as it saw fit. That does not, however, address the issue of what should then happen if the terms and conditions were unacceptable to the majority, and they no longer wished to terminate if they had to meet these conditions.

15.51 We think that there are some advantages in giving the court the wider role envisaged before the 2002 Act, of determining whether termination was appropriate in all the circumstances of the case. We think this approach provides greater protection for minority interests on voluntary termination. In particular, providing the court with discretion ensures that due consideration can be given to human rights considerations in any particular case.

15.52 If the court has discretion as to whether to approve an application for termination with 80% support, then as was previously envisaged the legislation could leave the court with an open-ended discretion. Alternatively, legislation could specify factors to guide the exercise of the court’s discretion. Opinions will differ as to the factors which can or should be taken into account, but the following seem to us to be relevant:

1. whether termination was being proposed because rebuilding was not possible, or it would be uneconomic to repair the building, or because an offer to purchase it was financially attractive;

2. exceptional hardship to a unit owner or a member of their family because of serious health problems;

3. the fact that an individual unit had been extensively adapted to take account of a disability;

4. the fact that the termination was supported principally by unit owners who were investor landlords (or who might be associates of the developers) and mainly opposed by unit owners who were owner-occupiers;

5. financial hardship to a unit owner who was objecting. This might include that a unit owner was in negative equity, and would remain liable on their personal covenant; or an owner would have difficulty in obtaining another mortgage; and

65 CLRA 2002, s 45(2).
whether suitable alternative accommodation formed part of the package being offered, or would otherwise be available.

15.53 The situation has some similarities with the position with applications for sale made under the Trusts of Land and Appointment of Trustees Act 1996. This Act governs the legal position where more than one person is the owner of a property, and they disagree as to whether it should be retained or sold. Sometimes they may have purchased a house together and, usually because of a breakdown of a relationship, they disagree as to when or whether it should be sold. Sometimes the dispute arises after relatives have jointly inherited land. Disputes may also arise because a joint owner’s share of land has had a charging order imposed on it, and the person who has the benefit of it wants the jointly owned property sold in order to repay the debt. However the dispute has arisen, the court has to decide whether the property should be sold, and, if so, on what terms. The discretion conferred on the court under the 1996 Act has been held sufficient to ensure that human rights considerations are sufficiently taken into account in determining applications for sale.

15.54 Although the Trusts of Land and Appointment of Trustees Act 1996 deals with situations with some similarities to those that arise on the voluntary termination of a commonhold, we do not think it is appropriate to rely too heavily on the principles set out in that Act, and the case law that has developed under it. One crucial difference is that, if a purchaser acquires an individual property with someone else, that purchaser ought to be aware of the possibility that it may have to be sold against his or her wishes. The courts have for many years been exhorting conveyancers to advise their clients of the implications of joint ownership. With commonhold the expectation is that a purchaser is getting freehold ownership of a unit, with only such restrictions or modifications as are necessary to take account of the communal aspects. This expectation points in the direction of setting a high threshold for voluntary termination.

15.55 If the court is to have discretion, then a difficult issue is the weight that should be attributed to the fact that the decision to terminate does have the support of at least 80% of the available votes. The Trusts of Land and Appointment of Trustees Act 1996 acknowledges that the wishes of the majority (by value) are a factor to be taken into consideration in deciding whether a property should be sold, but not the only factor. In order for a disputed application for voluntary termination to reach the court, it will already have the support of a very substantial majority of the available votes. It might appear that conferring discretion on the court would be negated if similar provision was made. Notwithstanding, it may be relevant for the court to take account specifically of

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66 This is a form of mortgage which is imposed by court order, so as to secure and enforce a previous court order for the payment of a sum of money.

67 A similar situation arises when one joint owner becomes bankrupt, and his or her trustee in bankruptcy wishes the property to be sold so that the bankrupt’s share can be used for the benefit of creditors, but applications to the court in such circumstances are governed by the rather stricter principles of the Insolvency Act 1986, s 335A.


70 Trusts of Land and Appointment of Trustees Act 1996, s 15.

71 Trusts of Land and Appointment of Trustees Act 1996, s 15(3).
the amount of support there is for voluntary termination over and above the 80% required.

15.56 If the court is to have discretion, then this should offer scope to address the situation where the terms imposed by the court to protect the dissenting minority were unacceptable to the majority who were seeking termination. We expect that the existence of this potential difficulty would emerge in the course of the hearing. We envisage that the judge would indicate the likely form of his or her order, and then adjourn the hearing. It would then be for the majority to decide whether they wished to proceed with the termination, or to seek permission to withdraw their application, on such terms as the judge saw fit.

15.57 In this Consultation Paper we are provisionally proposing that many disputes which may arise in the context of commonhold should go to the First-tier Tribunal (Property Chamber) in England or, in Wales, to the Residential Property Tribunal Wales (we use “the Tribunal” to refer to them both), rather than to a court. We think, however, that disputes involving the voluntary termination of the commonhold should remain in a court, which would generally be the Insolvency Court. Technical issues of accounting under the Insolvency Act 1986 may arise, even though, with a voluntary termination, the commonhold will almost always be solvent. We therefore think that a court is more likely to have the necessary expertise. We also recognise that it is a serious step to order the sale of a freehold property at the behest of neighbouring occupiers, and against the wishes of the owner, and think that such a decision is more appropriately made by a court.

Termination of a mixed-use or multi-block commonhold

15.58 The current law makes the assumption that a single vote will be taken across the commonhold if the question of voluntary termination should arise. Often, this will be appropriate. We explain elsewhere in this Consultation Paper that it will become increasingly common for commonholds to take the form of mixed-use and multi-block developments: for example residential, office, retail and leisure elements.72 We also think that it is likely that even where a commonhold is entirely residential it may include different types of properties: for example, houses on a development comprising mainly flats, or a block of modern flats built in the grounds of a commonhold based on the conversion of a listed building.

15.59 Commonholds such as these will raise novel problems when termination becomes an issue. For example, commercial buildings may become obsolete and ripe for redevelopment long before residential buildings built at the same time. If a commonhold includes both flats and houses, and the flats are seriously damaged in a fire, there may be a good case for deciding that it is more economic for the flats to be sold for redevelopment rather than reinstated, but that would not justify the houses being sold for redevelopment at the same time. The owners of the flats which have been built in the grounds of a listed building might wish to accept an offer to redevelop that part of the commonhold, but it may well be a foregone conclusion that planning permission to demolish and redevelop the listed building itself would not be granted.

72 See ch 5.
15.60 In Chapter 5, paragraph 5.39 onwards, we provisionally propose the use of “sections” to enable buildings or parts of a single commonhold to be self-managing. We provisionally take the view that, if the commonhold is already divided into sections, any vote on voluntary termination would need to be taken in sections, and whether it was unanimous or received at least 80% support would have to be determined by section. Even at section level, termination of a section may require some amendment to the CCS, particularly insofar as it relates to the relationship between the terminated and remaining sections and to the share of contributions to be paid by each unit.

15.61 It might be possible to accommodate some of the simpler “partial termination” problems under the existing law, by imaginative drafting of the termination statement. It might, for example, be possible to provide that, on the termination taking effect, the part of the commonhold occupied by the block of flats should be sold, and the owners of the houses on the estate would remain the freehold owners of those, but no longer as part of the commonhold, nor subject to the CCS.

15.62 Although superficially appealing, this approach seems to raise as many questions as it answers. The fact that the houses were included in a commonhold suggests that they were being provided with some common service, even if this service were no more than the upkeep of estate roads, or the provision of flood defences. Arrangements would have to be made for those to continue. It is therefore difficult to see how it would actually work in practice for the houses to drop out of the commonhold on termination.

15.63 The solution in such circumstances may lie in termination of the existing commonhold, and “reconstitution” of a new commonhold for the remaining parts, adopting the existing CCS. In the absence of sections, any vote on termination would need to involve the entire commonhold. The vote could, however, be coupled with a vote on reconstitution. That vote should require the same majority – unanimous support, or at least 80% support and an application to the court – but only of unit owners in the part of the commonhold to be reconstituted. We invite views as to how such a reconstitution could take place.

The interests of mortgage lenders and other secured lenders on voluntary termination

The status of the mortgage security

15.64 We have already noted at paragraph 15.36 above that there seems to be considerable concern among mortgage lenders and other secured lenders that their security over a commonhold unit may not be adequately protected in the event of the voluntary termination of the commonhold. We have also pointed out, in setting out the current law at paragraph 15.20 above that, on termination, lenders would retain their mortgages over individual units until the entire commonhold was eventually sold. We have further pointed out at paragraph 15.28(1), that the liquidator would be bound to repay secured loans out of the proceeds of sale of the commonhold, in order to ensure that a purchaser took the commonhold site free from mortgages on the individual units. It seems to us therefore that, under the law as it exists, lenders are in fact fully secured. Nevertheless, we appreciate that lenders’ concerns are genuinely held, and we consider that their position could be dealt with more explicitly in order to provide lenders with the confidence needed to lend on the security of a commonhold unit.
The practicalities of repaying the mortgage debt

15.65 Those lenders who are prepared to lend on the security of a commonhold unit impose a requirement on conveyancers acting for them in the following terms:

[you must] ensure that the commonhold community statement provides that in the event of a voluntary termination of the commonhold the termination statement provides that the unit holders will ensure that any mortgage secured on their unit is repaid on termination.

15.66 On the basis of the view we set out at paragraph 15.28(1) above, we are unclear of the purpose which this requirement is intended to serve. For the reasons given, we cannot see that the obligation to repay the mortgage could be excluded by the termination statement, even if the unit owners wished to do so. In any event, we suspect that such a provision may in practice offer lenders little protection, unless entrenchment is possible and the CCS has entrenched it. Further, even if it has been entrenched, it cannot be unamendable if the unit owners are unanimous. It also seems likely that it could be amended by an appropriate majority. Even if it remains binding, it could be disapplied by the court.

15.67 If the requirement is that the mortgage should be paid as soon as termination is approved, then it has been pointed out that this requirement will pose practical problems. Funds are unlikely to be available until the sale is completed (which will be some time after “termination” in the strict sense).

15.68 We also understand that mortgage lenders have more general concerns as to the position during the interval between the passing of a termination resolution and the eventual sale of the commonhold. Once the termination process has begun, the units will in practice be difficult or impossible to sell individually. Interest on the loan may be accruing and not being paid, but there will be little point in a lender taking possession if it is looking to exercise its power to sell the unit. Even if an offer has been made by a developer, it is likely to be several weeks or even months before the sale can be completed, even if there is 100% support for the termination. If there is less than unanimous support, as the matter has to go to court and perhaps have valuation issues resolved, the process is likely to extend over several months or even longer.

74 See ch 8, paras 8.62 to 8.67.
75 See ch 8, para 8.67.
76 See ch 8, para 8.67.
77 Clarke on Commonhold, 22[8], n 5, and 22[17]. A “workaround” is suggested by the authors at 7[48], which involves the lender agreeing to accept deferment of payment until completion.
78 A mortgage lender may take possession to recover rent being paid by a tenant, but will more often do so in order to sell the property in exercise of what is known as its “power of sale”.

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The status of the mortgage lender in the termination process

15.69 We have noted in paragraphs 1.156 and 1.163 of Commonhold: Legislative History that previous proposals would have given lenders a say in deciding whether a commonhold should be terminated or not, whereas the 2002 Act does not.

15.70 A lender who has taken possession of a unit before the termination process has begun will, as a “mortgagee in possession”, be entitled to exercise the vote or votes applicable to that unit. However, this right offers little ongoing protection to a lender, as neither members nor lenders in possession would be in a position to vote on further resolutions once a termination resolution had been passed. Lenders clearly have an interest in how the termination is conducted. The 2002 Act makes provision for persons falling within a prescribed class to have standing to make applications to the court on termination. It seems that matters such as these were intended to be covered by Commonhold Insolvency Regulations, which were never made. It is reasonable to assume that those with mortgages registered against units would have been given standing. We provisionally propose below that mortgage and other secured lenders should have standing to apply to the court in matters relating to termination. They might, for example, wish to raise questions over valuation issues, or the way in which the liquidator is conducting the termination.

15.71 Although a technical step of this nature would improve the position of lenders, we accept that lenders may still face practical problems. If a commonhold is being terminated because it has been severely damaged and cannot be reinstated, the likely delays may cause difficulties for lenders. But similar problems may arise for lenders if they have lent on a freehold house or a leasehold flat which is underinsured, or where the insurance is void. We do not therefore think that the problems which may occur within commonhold should receive a disproportionate emphasis. If termination is proposed purely for redevelopment, we suspect that unit owners will accept it because the offer to purchase is particularly attractive. If so, adequate funds are likely to be available to cover, for example, mortgage interest which accrues whilst the termination and sale are proceeding.

The position of the unit which is in “negative equity”

15.72 It is also possible that the requirement set out in the Council for Mortgage Lenders Handbook and quoted at paragraph 15.65 above may have a more wide-reaching effect, which is arguably unjust to other unit owners. Take the case of a unit which is subject to “negative equity” in the sense that the mortgage loan on it is higher than the market value of the unit itself. If the requirement means that in such cases the termination statement must still provide for the loan to be repaid in full from the proceeds of sale of the commonhold site, this can only be at the expense of other unit owners.

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79 Art 33 in the schedule to the Commonhold Amendment Regulations.
80 Eg CLRA 2002, ss 44(3)(b) and 45(4)(b).
This outcome does not seem to us to be fair. Normally if a lender has to sell a mortgaged property which is worth less than the amount of the mortgage debt, the lender would receive only what the property actually sold for (after deducting legal costs and estate agents' commission). The borrower would remain liable for the balance, but the lender would have to sue the borrower personally to recover that shortfall.

**Conversion of a voluntary termination into a creditors' voluntary winding up**

15.73 As explained in paragraph 15.7 above, a voluntary termination of a commonhold is a members' voluntary winding up of a company, under the Insolvency Act 1986. The provisions of the insolvency legislation apply even though a company can enter into a members' voluntary winding up only if it is in fact solvent. The directors are required to make a formal declaration of solvency before they may begin the procedure. Because the company is solvent, the directors can nominate the liquidator or liquidators.

15.74 Nevertheless, it sometimes turns out that, once a liquidator is appointed, he or she takes the view that the company is, in fact, unable to pay its debts. This situation may occur when the liquidator is first appointed, or further facts may come to light during the winding-up process. Provision is therefore made for the winding-up to be converted into a creditors' voluntary winding up. In broad terms, the effect of doing so is that creditors assume greater control of the process of winding-up, and can appoint their own nominee as liquidator, to replace the liquidator appointed by the directors.

15.75 The 2002 Act includes a provision which assumes that the voluntary termination of a commonhold can be converted into a creditors' voluntary winding up. Ordinarily a company which realises that it is insolvent and will be unable to meet its debts may accept the inevitable and begin the process for it to enter into a creditors' voluntary winding up, instead of waiting for a creditor, or creditors, to take action through the courts for an involuntary winding up. This option is not, however, available to a commonhold association.

It is arguable that this would be the result under the general law. Generally, if an individual is bankrupt, a secured lender will sell his or her property independently, and, having repaid their loan, account to the trustee in bankruptcy for any balance. If there was a shortfall, the lender would have to look to the borrower for the balance. If, on the other hand, the liquidator conducts the sale, the sale would not overreach the existing mortgage, so the secured lender could refuse to release its security unless the mortgage loan was repaid in full. In the context of the sale on termination, where a commonhold unit is in negative equity, this does not seem fair.

Under the Insolvency Act 1986, ss 95 and 96.

CLRA 2002, s 48(7)(b). The possibility of the Insolvency Act 1986, ss 95 and 96 applying, and the uncertainty of the consequences of this, are noted in *Clarke on Commonhold*, 22[18]; other commentators seem not to address it. The possibility of a members' voluntary winding up being converted into a creditors' voluntary winding up was noted in the Consultation Document “Termination of a Commonhold” (at 2.6), issued by the Department of Constitutional Affairs on 4 September 2003.

If a creditor wishes to put a commonhold association into liquidation, it would have to apply to the court.

See para 15.6(2) above.
In those rare instances where a commonhold association begins the process of voluntary termination, but it turns out in fact to be insolvent, a difficult and unusual situation arises. With an ordinary private limited company, the members of the company can decide to wind it up because they no longer wish it to continue trading (this is known as a “members’ voluntary liquidation”). If it then turns out that the company is in fact insolvent, it will affect the way that the liquidation is carried out. It will not, however, have any effect on the assets to which the liquidator has access.

The position with a commonhold association could well be different. If it decides to terminate the commonhold, it would begin the process of voluntary termination. This procedure is modelled on the “members’ voluntary liquidation” described above. But if the commonhold association subsequently turns out to be insolvent, there is a need to clarify what assets are then available for the liquidator to turn into cash. When it began as a voluntary termination, the value of the units would “form part of the pot”, as the intention of the unit owners was that they should all be sold. On the other hand, in the case of a compulsory winding up by the court— as we discuss in Chapter 5, only the assets of the association itself would be available to the liquidator. The unit owners would retain the value of their own units.

This confusing situation arises because, when the members wish to wind up the commonhold, they intend also to include the value of the units. When the commonhold is forced into insolvency by its financial position, the value of the units is excluded. They belong to the unit owners individually, and so are protected.

The commonhold association becomes the registered proprietor of the individual units only when the liquidator has notified HM Land Registry that he or she is content with the termination application, or the court has determined the content of the termination application. If any issue should therefore arise as to whether the commonhold association is insolvent, this would have arisen before the termination application is finalised, and the termination statement was being considered by the court. The termination statement could therefore make provision for the liabilities of the association to be met (so far as possible) from its funds, and for the value of the units to remain intact for the benefit of the unit owners (subject to the mortgages and other charges secured upon them).

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87 It would become what is called a “creditors’ voluntary liquidation”.
88 The company is insolvent if it owes more than it owns, and so cannot pay its debts in full.
89 CLRA 2002, s 50. This would then be on a petition for a “compulsory winding up by the court”. As with a “creditors’ voluntary liquidation”, it applies if the company is insolvent. (The position would be different if our proposal in ch 7 were adopted, so that the court would first appoint a “commonhold administrator” but this could still result in the court having to consider winding up the commonhold association).
90 Its current balances; the reserve fund balances; any debts owed to the association; and the value of the common parts.
91 CLRA 2002, s 49.
92 CLRA 2002, s 48(3)(b).
PROPOSALS FOR REFORM

The level of support required for voluntary termination

15.80 We provisionally propose that voluntary termination of a commonhold should be possible with either:

(1) unanimous support; or

(2) the support of 80% of the available votes plus the approval of the court.

15.81 We provisionally propose that on an application for voluntary termination the court should have discretion to decide whether to allow the voluntary termination to take place, as well as the terms on which it may do so.

15.82 We provisionally propose that an application for voluntary termination should be heard by the court rather than by the Tribunal.

15.83 We invite consultees' views as to whether guidance should be offered to the court as to the factors to be taken into consideration when considering whether it should exercise its power to approve a termination application. We invite consultees' views as to whether those factors set out in paragraph 15.52 above and/or others should be those that the court should take into consideration.

15.84 We provisionally propose that where a commonhold is divided into sections, any vote on voluntary termination would need to be taken in sections, and whether it was unanimous or received at least 80% support would have to be determined by section.

15.85 Where a commonhold is not divided into sections, we provisionally propose that it should be possible for part of the commonhold to be reconstituted following voluntary termination.

The position of tenants

15.86 We provisionally propose that if any statute provides that a landlord should be entitled to recover possession of a property if he or she can prove an intention to demolish or reconstruct the building, such a requirement should also be satisfied if it can be proved that the commonhold association has that intention.

15.87 We have identified certain considerations in paragraph 15.47 above that mean that it should not often be necessary to take into account the position of tenants when a commonhold is terminated. We are uncertain, however, whether the points we make there, and the provisional proposal we make at paragraph 15.86 above will satisfactorily address all the issues that may arise concerning the position of tenants on the voluntary termination of a commonhold. We therefore invite consultees' views on what further provision, if any, they think should be made.
Consultation Question 87.

15.88 We provisionally propose that voluntary termination of a commonhold should be possible with either:

(1) unanimous support; or

(2) the support of 80% of the available votes plus the approval of the court.

Do consultees agree?

15.89 We provisionally propose that on an application for voluntary termination the court should have discretion to decide whether to allow the voluntary termination to take place, as well as the terms on which it may do so.

Do consultees agree?

15.90 If the court has discretion as to whether to allow voluntary termination, We invite consultees' views as to the following issues:

(1) whether it would be useful to include factors to guide the court's discretion;

(2) whether the factors mentioned in paragraph 15.52 should be taken into account;

(3) whether the court should be directed to consider the amount of support there is for voluntary termination over and above the 80% required; and

(4) whether others should also be included.

15.91 We invite consultees' views as to whether increasing the role of the court would sufficiently address the issue of the final terms of the termination statement not being acceptable to those who supported the termination resolution.

15.92 We provisionally propose that an application for voluntary termination should be heard by the court (rather than by the First-tier Tribunal (Property Chamber), or in Wales the Residential Property Tribunal Wales).

Do consultees agree?
Consultation Question 88.
15.93 We provisionally propose that where a commonhold is divided into sections, any vote on voluntary termination would need to be taken in sections, and whether it was unanimous or received at least 80% support would have to be determined by section.

Do consultees agree?

15.94 Where a commonhold is not divided into sections, we provisionally propose that it should be possible for part of the commonhold to be reconstituted following voluntary termination.

Do consultees agree?

15.95 We provisionally propose that reconstitution should require 100% support of the unit owners in the part to be reconstituted, or at least 80% support and an application to the court.

Do consultees agree?

Consultation Question 89.
15.96 We provisionally propose that if any statute provides that a landlord should be entitled to recover possession of a property if he or she can prove an intention to demolish or reconstruct the building, such a requirement should also be satisfied if it can be proved that the commonhold association has that intention.

Do consultees agree?

15.97 We invite consultees’ views as to what further provision, if any, should be made to address the position of tenants on voluntary termination of the commonhold.

The interests of mortgage lenders and other secured lenders on voluntary termination
15.98 We provisionally propose that the position should be made clear that lenders will retain their secured interest in a unit until the commonhold is actually sold.

15.99 We also provisionally propose that it should be made clear that lenders are entitled to be treated automatically as having the right to participate in any legal proceedings relating to the termination.

15.100 We further consider that it should be explicitly provided that lenders’ secured interest should be confined to the value of the unit itself. This proposal means that if, for example, Unit A is in negative equity, it is not possible for a debt secured on Unit A to be repaid out of proceeds of sale which would otherwise have been distributed between
the other unit owners. This approach would not, of course, affect the lender’s right to hold the owner of Unit A personally liable to repay any shortfall under the terms of the mortgage agreement.

Consultation Question 90.

15.101 We provisionally propose that it should be clarified that mortgage lenders and other secured lenders will retain their secured interest in the commonhold units until the commonhold in its entirety is sold.

Do consultees agree?

15.102 We provisionally propose that mortgage lenders and other secured lenders should automatically have legal standing to make applications to the court during the termination process with a view to protecting their interests.

Do consultees agree?

15.103 We provisionally propose that it should be made clear that, if a unit is subject to negative equity, any shortfall should be met personally by the owner of the unit, and should not be covered by other unit owners.

Do consultees agree?

15.104 We invite consultees’ views as to any other ways in which the interests of mortgage lenders and other secured lenders may require protection on the voluntary termination of a commonhold.

The valuation of the commonhold and the units

15.105 We have noted at paragraph 15.34 above that the position under the current law is that the unit owners (or, more probably in practice, the developers) may decide in advance how the proceeds of sale of the site of the commonhold should be divided on termination. We have also noted that it is not compulsory to do so; that it can be deleted by an ordinary resolution; and that, if advance provision is made, that can be disapplied by the court. As the prescribed CCS does not require that provision be made for the share to be payable on termination (we shall refer to this as the “termination share”), it seems more likely that this will be left to be decided if and when termination should occur.

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93 We take the view that it is desirable that specific provision should be made for this scenario, because all the units would at this point be registered in the name of the commonhold association, but subject to any individual mortgages. The liquidator would be in control of the association. On a sale in such circumstances, the conveyancer acting for the liquidator would normally approach each secured lender to ascertain the “redemption figure”. Each lender would then agree that, if they received this sum, they would cancel the registration of the legal charge (mortgage). It might need to be established, by an application to the insolvency court, that the charge should be cancelled when the lender was paid the share applicable to the unit in “negative equity”.

94 Unless it has been successfully entrenched (see ch 8, paras 8.62 to 8.67).
15.106 Specifying the division of proceeds on termination in advance has some advantages. It reduces the scope for argument and owners know what the position is when they buy into the commonhold. On the other hand, the longer a commonhold endures, the less likely it will be that the predetermined termination share will be appropriate. The standard of internal decoration and repair of units may eventually diverge substantially. Some unit owners may install expensive fitted kitchens and bathrooms (which will form part of the freehold once installed). External factors may also intervene (for example, adjacent developments may lead to certain units losing an attractive sea view).

15.107 The section of the 2002 Act which permits a CCS to make provision for the rights of unit owners on termination does not necessarily mean that the CCS must specify the termination shares in advance.\(^95\) Making provision may include providing that rights be determined in a specified way. For example, the CCS might provide that the commonhold association can appoint a single valuer to determine all valuation issues.

15.108 We do not see any reason to change the current basic position. We do, however, provisionally propose that any application to disapply termination shares which have been predetermined in the CCS should be made to the Tribunal, rather than to the court. This proposal is consistent with the general preference of this Consultation Paper for disputes within commonholds to be decided by the Tribunal. It seems particularly appropriate here, as the comparative value of different units will be at issue, and valuation disputes are routinely considered by the Tribunal. We further note, however, that no guidance is given to the court as to when an advance determination of shares should be disapproved and wonder if it would be useful for guidance to be provided, whether for the court or the Tribunal. For example, a court or Tribunal could be directed to consider:

1. how long ago the advance determination was agreed;
2. what the circumstances were when the advance determination was agreed; and
3. how circumstances are alleged to have changed since the advance determination was agreed.

15.109 We would expect that where the shares have not been determined in advance, and no means of doing so is provided in the CCS, the distribution to be put in the termination statement would be a matter for negotiation. The statement would then confirm the percentage of the net proceeds of sale that each unit would ultimately receive after the sale of the entire commonhold. Substantial agreement would have to be reached in order to put forward figures in the termination statement which could command the support of at least 80% of the available votes.\(^96\) Where there is disagreement over the valuations of a minority of units the court will need to determine the final form of the termination statement.

15.110 In many cases where voluntary termination is proposed, the commonhold association will have received a definite offer for the entire commonhold from a developer. In some cases – for example, where a building has been damaged beyond economic repair –

\(^95\) CLRA 2002, s 47(2).
\(^96\) CLRA 2002, ss 43(1) and 47(1)(b).
the likely value of the commonhold may be more speculative. The requirement for a termination statement ought to work in either scenario. The figures provided in the statement to determine the distribution of the assets of the association would be the comparative values placed on the individual units. In other words, the statement will determine the proportions in which the assets would be distributed, regardless of the sale price which was ultimately achieved.

15.111 There is inevitably scope for dispute as to the valuation placed on each unit. Those valuations affect not only the unit owners, but may determine whether a sufficient sum is received to discharge a mortgage. It is therefore essential that all valuations are conducted on identical assumptions, and preferably by the same valuer.

15.112 Termination applications are governed by the Insolvency (England and Wales) Rules 2016, although these rules were not designed to deal with disputes of this nature. At the time of the 2002 Act it was anticipated that the Insolvency Rules then applicable would be supplemented by Commonhold Insolvency Rules, in respect of which two consultation documents were published, but no rules were actually issued.

15.113 In the event of a dispute, we have considered whether valuation issues could be referred as a discrete matter to the Tribunal. In such cases, we also wonder if the Tribunal should be left to hear evidence from experts appointed by the parties, or could appoint a single expert. We are also aware that a liquidator may refer any issue arising during the course of a liquidation to the Insolvency Court in a summary procedure. There is a danger that requiring that valuation issues can be determined only by a reference to the Tribunal could be a cause of delay.

15.114 In view of the potentially complicated valuation issues that would be involved, we would welcome views on whether:

(1) the Insolvency Rules are an adequate and convenient way of dealing with the valuation issues that would be involved; or if further provision should be made (for example, by way of Commonhold Insolvency Rules) to address valuation issues; for example, by providing for the appointment of a single, court-appointed expert;

(2) disputes on valuation issues should be referred as a discrete matter to the Tribunal;

(3) the Tribunal should be able to appoint a single valuer to provide expert evidence.

97 SI 2016 No 1024. Part 5 deals with Members' Voluntary Winding Up. This is included in the Insolvency Rules, though the procedure can apply only if the company is solvent.


99 Insolvency Act 1986, s 112.

100 Our attention has been drawn to the power contained in the Landlord and Tenant Act 1987, s 33(2)(a) for the Senior President of Tribunals to appoint a surveyor to value the interest of a landlord who cannot be found, though this is perhaps rather different from the situation where competing expert evidence needs to be resolved.

101 A similar power exists under CLRA 2002, s 176A.
15.115 Where a commonhold remains solvent despite being substantially destroyed, we provisionally suggest that, for the purpose of the termination statement, the units ought to be valued on the basis of their pre-damage value, so that any mortgage could be deducted from the termination share attributable to that unit.

15.116 As it is likely to be impossible for a valuer to carry out a proper valuation of the units in a building which had been substantially destroyed, the valuation would have to be based on such evidence as is available. In the case of a building comprising identical units the valuer might have to assume that they were all of equal value, unless there was strong evidence to justify some other termination share. This approach would not be possible if the units were of substantially different sizes, but it seems safe to assume that the commonhold plan would give a valuer sufficient information to produce valuations based on floor area.
Consultation Question 91.

15.117 We provisionally propose that the CCS should not be required to specify the share of the proceeds of termination that each unit owner is to receive on termination.

Do consultees agree?

15.118 We provisionally propose that it should be possible for the unit owners to specify the share of the proceeds of termination that each unit owner is to receive on termination (or some method of ascertaining it) in the CCS.

Do consultees agree?

15.119 We provisionally propose that the power to decide an application to disapply a provision in the CCS which determines the distribution of proceeds of sale on termination should lie with the Tribunal.

Do consultees agree?

15.120 We invite consultees’ views as to whether:

1. guidance should be provided to the court or Tribunal as to how it should exercise its discretion; and

2. if guidance should be provided, what factors the court or Tribunal should take into account.

15.121 We invite consultees’ views as to whether:

1. the existing rules of the Insolvency Court would be adequate to deal with valuation issues which arise on the voluntary termination of a commonhold, or need to be supplemented by Commonhold Insolvency Rules;

2. all issues involving the valuation of commonhold units on termination should be referred to the Tribunal (and, if so, whether that would cause any unnecessary delays);

3. if valuation issues are referred to the Tribunal, the Tribunal should be able to appoint a single valuer.

15.122 We provisionally propose that, if a commonhold is substantially destroyed, but remains solvent, for the purposes of the termination statement, the units should be valued on the basis of the best estimate that can be made of their pre-damage value.

Do consultees agree?

15.123 We invite consultees’ views as to any other issues that might occur in the valuation of units if all or some of them have been partly or entirely destroyed. We also invite any suggested solutions.
Conversion of a voluntary termination into a creditors’ voluntary winding-up

15.124 We have noted at paragraph 15.73 above that what has started out as a voluntary termination may, on very rare occasions, have to be converted into a winding up on behalf of the creditors102 because the commonhold association is insolvent. We take the view that in such a case, we should then attempt to apply the same overriding principles as would apply if the commonhold association had been made insolvent by a creditor applying to the court. This approach could mean that the liquidator would have access to the assets of the association in the narrow sense,103 and the unit owners would retain the value of their units.104 Where possible, that would seem the correct thing to do.

15.125 The more difficult problem is what should be done where, in the case of destruction of a building, the units have largely lost their value, and the loss cannot be recovered, because of underinsurance, or a void insurance policy. Attributing to the unit owners the notional value of their units before they were destroyed can serve as the basis for calculating the owners’ eventual termination shares. This would be the percentage of the proceeds of sale to be notionally credited to them. Some individual unit owners may not, however, then receive anything if the sums of money outstanding on a mortgage or other charges registered against their own unit is more than that percentage share. We invite consultees’ views as to whether it is realistic to adopt this approach when the building has been substantially destroyed.

Consultation Question 92.

15.126 We provisionally propose that if the process of voluntary termination should begin, but it should subsequently turn out that the commonhold is in fact insolvent, the same protections should be given to the assets of the individual unit owners as would have applied if the process had begun as an involuntary insolvency.

Do consultees agree?

15.127 We invite consultees’ views as to whether the value of the individual units should be preserved for the unit owners if the commonhold is substantially destroyed; and, if so, how this can be achieved.

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102 That is, a “creditors’ voluntary liquidation”.
103 See n 90 above.
104 Where the commonhold was reasonably well insured, the monetary value of the units would be preserved, even if, for some other reason, such as an obsolescent design, it was not appropriate to reinstate the building.
Part VIII: Impact and application of reform
Chapter 16: The impact and application of commonhold reform in England and in Wales

INTRODUCTION

16.1 Commonhold, though a freehold interest, offers a different way of owning land. We think that commonhold is likely to have important implications for property ownership and the property market. In this chapter we pose some questions to consultees to help with the assessment of the impact that our provisional proposals are likely to have.

16.2 Alongside our law reform project, Government is considering what measures may need to be taken to incentivise commonhold, or if its use should be made compulsory. We ask an additional question to assist Government in its consideration of these issues. We will share responses to these questions with Government.

THE IMPACT OF OUR PROVISIONAL PROPOSALS

Impact on existing commonholds

16.3 In fairness to those developers, conveyancers and purchasers who have pioneered the use of commonhold, we must firstly consider the impact of our provisional proposals on those who already own commonhold units, and are therefore members of commonhold associations. They are, however, a select band. Fewer than 20 commonholds have been registered since 2004, when the 2002 Act came into force. The overall economic impact of any changes to the law, so far as it affects the existing commonholds, will therefore be minimal. We nevertheless wish to ensure that their interests have been considered.

16.4 We do not consider that any of our provisional proposals will substantially increase the burden of regulation on existing commonhold associations. If our proposals are implemented, directors would, for example, have to get the contributions to shared costs, and to any reserve funds, approved by a vote of the unit owners.\footnote{Ch 10, paras 10.32 and 10.34.} We do not, however, think that our proposed reforms should require associations to undertake a great deal more work, or incur more expenditure.

16.5 We think that our provisional proposals will, overall, improve the position of existing commonholds. In our Call for Evidence some unit owners in existing commonholds told us that they had experienced difficulty in obtaining mortgage finance to purchase their units. Some said that they feared that they might have difficulty in selling their units. Some prospective purchasers of units might be put off because they are unfamiliar with commonhold, or because of difficulties in finding a mortgage company willing to lend. Their position will certainly be improved if commonhold is reinvigorated, so that it becomes more "mainstream". The proposals we make to improve how the payment of commonhold contributions can be enforced should also assist them.\footnote{See ch 14, paras 14.47 to 14.71.}
commonholds may also wish to take advantage of some of the opportunities that we propose for them to operate more flexibly.

**Consultation Question 93.**

16.6 We invite consultees’ views as to whether, and how, any aspects of our provisional proposals to reform the law of commonhold will affect the position of existing owners of commonhold units, either positively or negatively.

**Impact of our reforms for the future**

16.7 In view of the limited number of commonholds in existence, it is self-evident that our provisional proposals for reform will have a much more substantial impact if they result in commonhold being adopted more widely. We wish therefore to gather evidence on the likely and potential impact that our reforms may have.

16.8 In our Call for Evidence we asked a general question asking those with experience of leasehold to let us know what they thought the advantages of commonhold would be. Consultees who responded to that question in our Call for Evidence need not send their response to us again; we will continue to refer to their responses. But we also wish to give those who did not respond to our Call for Evidence the opportunity to give us their views.

**Consultation Question 94.**

16.9 What advantages do you think commonhold could offer over leasehold?

**Implications for litigation and other legal costs**

*C\losses incurred in standard conveyancing transactions*

16.10 In response to our question in our Call for Evidence about the advantages of commonhold over leasehold, 18 respondents noted the advantages of simplification and standardisation, including academics who are familiar with commonhold and similar systems of ownership in other countries. Practitioners also thought that there was scope for savings here. Birmingham Law Society commented:

commonhold would also be advantageous to lawyers. The leasehold system can be complex and complicated for the most experienced lawyer…. Conveyancing solicitors should find the transfer of flats easier, as there would be no need to wade through a lengthy lease each time. Instead community associations and statements will have to be in standard forms (similar to the “Declaration” in the Condominium system in North

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3 Commonhold Call for Evidence, question 12.
4 Prof James Driscoll and Mr Peter Smith.
America) in accordance with the 2002 Act. The possibility of having one codified system would be a huge plus for everybody.

16.11 The commonhold community statement (“CCS”) as set up by the 2002 Act will remain an important feature of commonhold under our proposals. The most important provisions of the CCS will be standard, and will continue to be set out in regulations made by Government with the approval of Parliament. These provisions can be updated from time to time as necessary. Individual commonholds can then adopt their own local rules to supplement but not to contradict these provisions. We are proposing some amendments to the structure of the CCS to distinguish more clearly between the standard parts and the local rules. This should make it even easier to identify in what respects the provisions in any given commonhold differ from the standard. The standard parts of the CCS would be available online, which would emphasise that the updated wording takes precedence over older versions. Commonhold associations could nevertheless be required to provide printed copies of the updated CCS to unit owners.

Consultation Question 95.

16.12 We ask consultees to provide us with information about the time spent in reading through and considering the terms of leases of residential flats:

1. when acting for a prospective purchaser;
2. when acting for a prospective purchaser and mortgage lender;
3. when acting for a mortgage lender on a re-mortgage;
4. when some dispute arises within a leasehold block of flats as to responsibility for repairs and maintenance, calculation of the service charge, and similar disputes.

16.13 In each case we also invite consultees to give us some idea of the cost that would thereby be incurred to the client.

16.14 We further invite their views as to whether time is likely to be saved in reading through and considering the terms of the parts of the CCS which may be varied.

16.15 We invite consultees to share with us their experience of commonhold-type arrangements in other countries. Is there scope for savings of time to be made? If so, what would be the estimated time saved on a typical transaction?

Costs incurred when leases contradict one another

16.16 There is potential for time to be saved on the transfer of a flat or other unit if the documentation can, so far as possible, be standardised. Another issue we are aware of is that leases may contradict each other. Such inconsistent terms can give rise to disputes. Especially if leases within the same block have been granted at different times, they may contain terms which:
(1) divide up the building between individual units and the common parts in inconsistent ways (for example, ownership of doors and windows);

(2) contain different arrangements for the calculation or collection of service charges; or

(3) contain rules or restrictions which are not contained in other leases.

16.17 We think that the scope for such disputes will be much reduced in commonhold, as the relationships between the commonhold association and the unit owners, and between the different unit owners, will always be governed by a single CCS.

Consultation Question 96.

16.18 We ask consultees to provide us with information about the prevalence of, and costs incurred in, disputes caused by the terms of one or more residential leases being inconsistent with the terms of another lease (or other leases) within a building or development. We further invite their views as to whether our provisional proposals for commonhold will reduce the scope for costs to be incurred in interpreting a commonhold community statement.

Costs incurred in varying or updating leases

16.19 Another often-cited advantage of commonhold is that it is easier to amend and update the terms of a CCS than it is to vary a group of leases within a block. Most often the leases have to be varied simultaneously, and that can create logistical problems, even if all the leaseholders and their mortgage lenders are agreed on how the leases should be varied. We understand that, for this reason, leases within blocks with numerous flats are sometimes varied by taking advantage of the facility to apply to the Tribunal\(^5\) for an order varying the leases.\(^6\) We further understand, however, that, because of the trouble and expense involved, few applications to vary leases are in fact made to the Tribunal.

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\(^5\) In England, the First-tier Tribunal (Property Chamber); in Wales, the Residential Property Tribunal, Wales.

\(^6\) Under the Landlord and Tenant Act 1987, s 37.
### Consultation Question 97.

16.20 We ask consultees to provide us with information about the sort of difficulties that can arise owing to the difficulty in varying and updating the terms of leases:

1. if the leases are varied as a conveyancing transaction which does not give rise to a dispute;\(^7\) and

2. if the leases are varied as a result of an application to the Tribunal (whether the application was made because it was contested, or because it was the most convenient way of implementing the variation).

16.21 If you have figures – whether they relate to the costs incurred, or the amount of time spent – then please let us have them.

16.22 We further invite consultees’ views as to whether our proposals regarding the amendment of local rules by resolution of the commonhold association will reduce the costs which are incurred, when compared with the costs incurred under (1) or (2) above.

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**Saving of costs on service charge disputes**

16.23 Our consultees have suggested to us that a good deal of time and expense goes in to resolving disputes over service charges, including:

1. disputes over the interpretation of the relevant provisions in leases;

2. disputes as to whether service charges have been reasonably incurred;\(^8\) and

3. disputes where it is alleged that the consultation requirements have not been complied with (including applications for permission to dispense with the consultation requirements).\(^9\)

16.24 We are aware that disputes such as these may arise in cases where the expenses have been incurred by a leaseholder-controlled company,\(^10\) whether or not the leaseholder who is making the application is a member of the company.

16.25 Although there is still some scope within a commonhold for a dispute to arise as to the level of contributions to shared expenses, we take the view that this will be considerably reduced within commonhold, compared with leasehold.

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\(^7\) In lawyers’ terms, this would be as a “non-contentious” matter.

\(^8\) Landlord and Tenant Act 1985, s 19.

\(^9\) Landlord and Tenant Act 1985, s 20.

\(^10\) That is to say, a freehold management company, a residents’ management company, or a right to manage company. These terms are all defined in the Glossary.
Consultation Question 98.

16.26 We invite consultees to provide us with information about costs generated by service charge disputes. We further invite their views as to whether, and by how much, our provisional proposals for commonhold will reduce the incidence of disputes and the costs that will be incurred in equivalent disputes over contributions to shared costs.

Saving of costs of forfeiture proceedings

16.27 At present, if a landlord (including a freehold management company (“FMC”)) needs to enforce payment of service charges against a leaseholder, he or she will often need to use forfeiture proceedings. This process can be protracted and technical, as first the debt must be established, then a notice must be served, and only then can forfeiture proceedings be begun. This multi-stage procedure was introduced because of the draconian nature of forfeiture. We are proposing that the commonhold association should have a statutory charge over a unit for all arrears; if the association then wishes to enforce it by obtaining an order for sale, safeguards for the unit owner would be built in to the procedure. The process would also be fairer, in that the balance remaining after the unit was sold would be paid to the unit owner.

16.28 We take the view that, because they can so often turn on technicalities, forfeiture proceedings can often be unnecessarily expensive. We hope that it will rarely be necessary for a commonhold association to seek an order for sale of a unit, but think that, when it is necessary, the legal costs should be lower than with forfeiture, because the procedure will be more straightforward.

Consultation Question 99.

16.29 We invite consultees to provide us with information about costs generated when forfeiture proceedings need to be used to enforce payment of service charges. We further invite their views as to whether our provisional proposals for commonhold will reduce the costs that will be incurred if a commonhold association needs to seek an order for sale.

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11 See CLRA 2002, s 170.
12 Ch 14, para 14.58.
Implications of the transfer of jurisdiction over many commonhold disputes to the Tribunal

16.30 In this Consultation Paper we provisionally take the view that disputes within a commonhold should generally go to the Tribunal. We make relevant provisional proposals throughout the Consultation Paper in this respect. Only exceptionally do we propose that the court should have jurisdiction.\textsuperscript{13}

16.31 Generally, it would be assumed that transferring jurisdiction from a court to a tribunal is likely to save legal costs. In the context of this consultation, however, it is potentially unrealistic to assume that. If commonhold is more widely adopted, then it is likely that commonholds will be set up in circumstances where currently leasehold is used. Many leasehold cases are currently heard by the Tribunal. It is likely that disputes of a similar nature will in future still be heard by the Tribunal, if our proposals are adopted.

Consultation Question 100.

16.32 We invite consultees' views as to:

(1) whether cases before tribunals are likely to prove more or less expensive than similar cases before courts; and

(2) whether (apart from service charge disputes, which we have already addressed in Consultation Question 98) there appears to be more or less scope for disputes within commonholds which result in litigation, when compared with leasehold developments.

Implications of the creation of new Tribunal jurisdiction over commonhold disputes

16.33 We have said above that many disputes within commonholds (which we are proposing should be heard by the Tribunal) will, in effect, take the place of leasehold disputes which would currently be heard by the Tribunal. In a number of instances, however, we have provisionally proposed that the Tribunal should hear disputes within a commonhold where there is at present no facility to make an application either to the court or the tribunal. These instances include, by way of examples:

(1) our proposal that, if no one is prepared to serve as a director of commonhold association, it should be possible for an interested party to apply to the Tribunal for the appointment of paid directors;\textsuperscript{14} and

(2) our proposal that, in several instances where the minority may require protection from a decision validly made by the majority, they should be able to apply to the

\textsuperscript{13} We propose that the court should have jurisdiction in cases involving the insolvency of the commonhold (ch 7) or the termination of a commonhold (ch 15) where issues involving the Insolvency Rules are likely to arise. In such cases the expertise of the Insolvency Court is likely to be relevant. We also propose that only the court should have power to order the sale of a unit to recover arrears: see ch 14, paras 14.47 to 14.71.

\textsuperscript{14} See ch 9, para 9.36.
Tribunal for their position to be considered, with a view to the Tribunal offering an appropriate remedy.  

**Consultation Question 101.**

16.34 We are provisionally proposing several new grounds upon which it would be possible for someone to make an application to the Tribunal. We invite consultees’ views as to:

1. what they consider that the likely impact of these will be on the number of applications made to the Tribunals; and
2. whether any particular proposals are likely to result in a large number of new applications being made.

**Other costs and benefits**

**Consultation Question 102.**

16.35 We invite the views of consultees as to how any other aspects of our provisional proposals for reform of commonhold will affect the position of future owners of commonhold units, either positively or negatively.

**Potential impact on large-scale and mixed-use developments**

16.36 One reservation that has been expressed over the use of commonhold is that it will make it more difficult for developers to develop large-scale developments. These developments may cover a substantial area, and be developed over a prolonged period of time. These concerns were expressed by Berkeley Group Holding plc in response to our Call for Evidence:

we asked Taylor Wessing LLP, property lawyers with offices in jurisdictions that have commonhold style tenure, to apply a commonhold structure to our development at Royal Arsenal. They found the complexities of the Royal Arsenal development made it an unacceptably complex structure involving a number of commonholds with overlapping interests and vastly differing numbers of members.

16.37 We make provisional proposals to address the concerns expressed by Berkeley Group Holding plc and other developers. It has been suggested to us, however, that, if these concerns are not sufficiently addressed, the result will be that developers will be reluctant to set up such large, mixed-use developments in future. These could be inner-city, “brownfield” developments, or developments based, say, on the refurbishment of

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15 See ch 13, para 13.90 and 13.91. The other instances where we suggest a role for the Tribunal are in paras 3.144, 5.81, 5.90, 5.102, 10.43, 10.79, 11.29, 11.37(2), 13.90, and 15.119 above.

16 In ch 5, and ch 6.
former public buildings such as hospitals in the countryside outside towns and cities. Instead developers may redevelop large sites with discrete areas for different types of housing, and separate areas for different types of commercial development. They have also suggested that, if areas are developed in this way, there will be considerably less scope for local authorities to negotiate planning agreements with them.\footnote{Notably, under the Town and Country Planning Act 1990, s 106.} We have come across examples where these agreements may require the developers:

(1) to include social or affordable housing as part of the development;

(2) to require the building of community facilities such as schools or doctors’ surgeries;

(3) to contribute towards roadbuilding costs; or

(4) to provide flood defences for an area.

These large-scale developments can also be structured so that estate roads within the development do not need to be adopted and maintained at public expense. Instead they are maintained at the expense of the residents through their service charges. These charges may even cover expenses relating to the provision of security officers or police.

Consultation Question 103.

16.38 We ask consultees to provide us with any information that they may have of:

(1) examples of planning agreements which are practicable under leasehold but which would not appear to be feasible under our reinvigorated model of commonhold; and

(2) services within leasehold developments which are being provided at the residents’ expense, but which, if the development had been set up on a commonhold basis, would have been provided, if at all, at public expense.

16.39 Some respondents to our Call for Evidence, and stakeholders with whom we have spoken, have suggested that commercial units which are contained within a commonhold will be less attractive to investors (or to businesses which intend to use them for their own occupation). Developers, and the institutional investors who currently purchase freehold reversions from them, say that owners and tenants of commercial units would prefer to know that they will be managed by experienced commercial property managers. They are afraid that, within a commonhold, strategic decisions will be made by directors who are owners of residential units and have no experience of the world of commercial property. Even if the directors of the commonhold engage managing agents to take charge of the day-to-day management, these are likely to be more experienced in managing residential units than commercial units.
16.40 We are aware that the scenario where commercial units are being managed by leaseholder-controlled companies may arise under the present law, in particular where a FMC has acquired the freehold (or a right to manage company is managing a block). In some rare cases the FMC may either be letting commercial units directly to tenants, or there may be a leaseback arrangement to a former landlord, who is then subletting the units to the commercial tenants.

**Consultation Question 104.**

16.41 We ask consultees to provide us with any evidence they have of management difficulties which may arise where a leaseholder-controlled company is the landlord of (or responsible for the management of) commercial units; and whether this has affected their rental or capital value.

**STEPS FOR POSSIBLE GOVERNMENT ACTION**

16.42 Underlying our commonhold project is the fact that although commonhold has been on the statute-book since 2002, and it came into force in 2004, it has been used very little in practice. Our Terms of Reference require us to make recommendations that would “reinvigorate” commonhold. We wish therefore to gauge consultees’ overall reactions to the provisional proposals in this Consultation Paper. So we ask consultees to consider the proposals, and to respond to the following consultation question.

**Consultation Question 105.**

16.43 Which of the following statements best reflects your views on the provisional proposals in this Consultation Paper?

1. If these proposals are adopted, then developers will be willing to use commonhold for a substantial number of developments.

2. Even if these proposals are adopted, developers will not be willing to use commonhold unless Government introduces financial incentives for them to do so, either directly by offering financial incentives for the developers, or indirectly, by offering incentives for purchasers of commonhold units.

3. Even if these proposals are adopted, and financial incentives are given, developers will not use commonhold for developments unless they are prohibited from selling flats on a leasehold basis and they are thus forced to use commonhold.

16.44 We do not wish in any way to prejudge how consultees may respond to the previous question. We have, however, agreed with Government that this Consultation Paper offers the best and most appropriate opportunity to ascertain consultees’ views on additional measures Government may take in respect of commonhold. Therefore, We

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18 See ch 1, para 1.4.
invite consultees' views as to the possibility of offering financial incentives to encourage the take-up of commonhold, and the question of whether the adoption of commonhold should be compelled.

16.45 In our Call for Evidence we asked various questions about matters which might affect the adoption of commonhold, including:

- financial incentives to prefer leasehold;
- lack of consumer awareness; and
- difficulty in obtaining finance.

16.46 Consultees who responded to our Call for Evidence need not send their response to us again; we will continue to refer to their responses. Those responses have helped us to identify specific measures that consultees may wish to share their views on. We also wish to give those who did not respond to our Call for Evidence the opportunity to give us their views.

16.47 The following suggestions to reinvigorate commonhold were raised with us during the Call for Evidence:

- offering some incentive on Stamp Duty Land Tax which would make commonhold more attractive to buyers when compared with leasehold;\(^{19}\)
- advertising campaigns;
- a Government website bringing together all information relevant to commonhold;
- implementation of Government's proposal to ban substantial ground rents in leasehold developments;
- requiring all advertisements for properties for sale to contain basic details of their tenure, for example:
  - freehold
  - commonhold
  - leasehold with xx years left on the lease
  - leasehold with xx years left on the lease, and with share of freehold; and
- compelling the adoption of commonhold for all developments which include flats.

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\(^{19}\) A number of respondents to our Call for Evidence suggested this, including the Commercial Real Estate Legal Association, Ms Letitia Crabb (retired academic) and Lord (Robert) Walker (retired Justice of the Supreme Court). In Wales Land Transaction Tax replaced Stamp Duty Land Tax with effect from 1 April 2018.
Consultation Question 106.
16.48 We invite consultees’ views as to:

(1) what issues prevent the uptake of commonhold; and

(2) what could or should be done to promote the adoption of commonhold.

16.49 We invite consultees’ views as to the extent to which the suggestions for the invigoration of commonhold set out in paragraph 16.47 above, and any other suggestions that they may make, are likely to result in commonhold being used instead of leasehold.

THE LAW IN ENGLAND AND IN WALES

16.50 Our project is intended to cover both England and Wales, and to result, where reasonably possible, in a uniform set of recommendations that are suitable for both England and Wales. Nevertheless, we seek consultees views on whether any specific considerations in England or in Wales call for particular issues to be treated differently in England and in Wales. Consultees are welcome to share their views on this point here, or in response to any of the questions which we ask in this Consultation Paper.

Consultation Question 107.
16.51 We invite consultees’ views as to whether a reformed commonhold regime should treat particular issues differently in England and in Wales. Consultees are welcome to share their views as to this point here, or in response to questions which we ask throughout the Consultation Paper about particular issues.

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20 See ch 1, paras 1.85 to 1.87.
Chapter 17: Consultation Questions

Consultation Question 1.
17.1 In order to protect freeholders, we provisionally propose that it should only be possible to convert to commonhold if either:

(1) the freeholder consents; or
(2) the leaseholders satisfy the qualifying criteria for collective enfranchisement, and acquire the freehold as part of the process of converting to commonhold.

Do consultees agree?  
Paragraph 3.31

Consultation Question 2.
17.2 We provisionally propose that it should be possible to convert to commonhold without the unanimous consent of leaseholders.

Do consultees agree?  
Paragraph 3.41

Consultation Question 3.
17.3 We provisionally propose that only leaseholders who are eligible to participate in a collective enfranchisement claim should take a commonhold unit and should be able to participate in a decision to convert to commonhold.

Do consultees agree?  
Paragraph 3.54
Consultation Question 4.

17.4 If non-consenting leaseholders retain their leases following conversion to commonhold (which we call “Option 1”):

(1) We provisionally propose that it should be possible for conversion to take place with the support of long leaseholders of 50% of the flats in the building. Do consultees agree?

(2) We provisionally propose that non-consenting leaseholders should be provided with a statutory right to purchase the commonhold interest in their unit at a later date. Do consultees agree?

(3) We provisionally propose that the right to purchase the commonhold interest should replace non-consenting leaseholders’ statutory rights to obtain a lease extension and to participate in a collective enfranchisement. Do consultees agree?

(4) We invite the views of consultees as to whether a purchaser from a non-consenting leaseholder should be required to purchase the commonhold interest, as well as the leasehold interest.

(5) We provisionally propose that the leaseholders should be able to require the freeholder to take new 999-year leases over any flats not let to qualifying tenants and that such leases should automatically be granted over flats let to statutorily protected non-qualifying tenants and shared ownership leaseholders. Do consultees agree?

(6) We invite the views of consultees as to whether the non-consenting leaseholders’ share of the freehold purchase should be capable of being funded:

(a) by the consenting leaseholders, through the commonhold association which holds the commonhold interest;

(b) by the consenting leaseholders, through a company (owned by them) which acquires the commonhold interest;

(c) by a third-party investor, who acquires a long lease of the commonhold unit superior to the non-consenting leaseholder’s lease;

(d) by granting a leaseback to the freeholder (who may be compelled to accept the lease), who acquires a long lease of the commonhold unit superior to the non-consenting leaseholder’s lease; and/or

(e) by any other means.

Paragraph 3.104
Consultation Question 5.

17.5 If non-consenting leaseholders are to be required to take a commonhold unit following conversion to commonhold (which we call “Option 2”):

(1) We provisionally propose that that qualifying leaseholders of 80% of the flats in the building should be required to support the decision to convert. Do consultees agree?

(2) We provisionally propose that the leaseholders should be able to require the freeholder to take the commonhold unit of any flats not let to qualifying tenants and that freeholders should automatically become the unit owner in respect of any flats let to statutorily protected non-qualifying tenants and shared ownership leaseholders. Do consultees agree?

(3) We provisionally propose that it should be possible to place a charge over non-consenting leaseholders’ units to recover their share of the initial freehold purchase price upon future sale of their commonhold unit. Do consultees agree?

(4) If consultees do not agree, how should non-consenting leaseholders’ share of the purchase price be financed?

(5) We invite the views of consultees as to who should be able to provide such finance and take the benefit of the charge.

(6) We invite the views of consultees as to whether the charge should be set:

   (a) as a fixed amount, representing the non-consenting leaseholder’s share of the initial freehold purchase;

   (b) as that fixed amount, with interest;

   (c) as that fixed amount, adjusted in line with house price inflation;

   (d) as a percentage of the final sale price, representing the percentage increase in value of the non-consenting leaseholder’s property interest (from leasehold to commonhold) on conversion; or

   (e) in some other way.

(7) We invite the views of consultees as to what priority this charge should have in relation to any pre-existing charges.

Paragraph 3.142
Consultation Question 6.

17.6 Where a freeholder or non-consenting leaseholder, who has let his or her flat to a non-qualifying tenant on a variable service charge, is required to take a commonhold unit on conversion under Option 2, we invite consultees’ views as to whether:

(1) a cap should be placed on the amount of commonhold costs which are recoverable from the former leaseholder or freeholder, to reflect the costs that are recoverable from the non-qualifying tenant;

(2) the non-qualifying tenant’s rights should be altered so that he or she no longer has the right to challenge service charge costs after they have been incurred, but instead has the same rights to challenge commonhold costs as other unit owners; or

(3) any other approach would fairly protect and balance the competing interests of the leaseholder or freeholder, and the non-qualifying tenant.

Paragraph 3.143

Consultation Question 7.

17.7 Under Option 2, we provisionally propose that:

(1) those wishing to convert (with less than unanimous consent) should be required to seek the prior authorisation of the First-tier Tribunal (Property Chamber) or Residential Property Tribunal in Wales (“the Tribunal”); and

(2) the Tribunal should be required to authorise a conversion to commonhold unless:

(a) the necessary consents have not been obtained;

(b) the terms of the CCS do not adequately protect the interests of non-consenting leaseholders; and/or

(c) the applicants refuse to adopt the Tribunal’s proposed revisions to ensure the CCS sufficiently protects the interests of non-consenting leaseholders.

Do consultees agree?

Paragraph 3.144
Consultation Question 8.

17.8 We provisionally propose that on conversion to commonhold, tenancies granted for 21 years or less should continue automatically on conversion and that the consent of such tenants should not be required in order to convert to commonhold. Do consultees agree?

Paragraph 3.152

Consultation Question 9.

17.9 We invite consultees’ views as to whether it should be possible for charges to transfer automatically from the leasehold title to the commonhold unit title on conversion to commonhold, without requiring lenders’ consent.

Paragraph 3.172

Consultation Question 10.

17.10 We have set out two options for setting the threshold of leaseholder support which should be required to convert to commonhold. The first would be to require leaseholders (who are qualifying tenants under enfranchisement legislation) owning at least 50% of the flats in the building to consent, provided non-consenting leaseholders are able to retain their leasehold interest on conversion to commonhold (Option 1). The second would be to require leaseholders (who are qualifying tenants under enfranchisement legislation) owning at least 80% of the flats in the building to consent, on the basis that non-consenting leaseholders are required to take a commonhold unit on conversion (Option 2).

17.11 We invite consultees’ views as to whether they prefer Option 1 or Option 2.

17.12 We invite consultees’ views as to any other options for setting the threshold of leaseholder support for conversion, other than Options 1 and 2, which strike an appropriate balance between the interests of those wishing to convert and non-consenting leaseholders, and provide a mechanism for financing the freehold purchase.

Paragraph 3.182
Consultation Question 11.
17.13 We provisionally propose that, where the freeholder refuses to consent to conversion, the leaseholders will need to follow the collective enfranchisement process to purchase the freehold in order to convert to commonhold.

Do consultees agree?

Paragraph 4.18

Consultation Question 12.
17.14 We provisionally propose that, to simplify the procedure for converting to commonhold, any consents given in support of the conversion should not automatically lapse after 12 months.

Do consultees agree?

17.15 We invite consultees’ views as to whether leaseholders should be able to withdraw their individual consent to conversion after the Claim Notice has been served, or whether leaseholders should be required to make a collective decision no longer to proceed with the conversion.

Paragraph 4.43

Consultation Question 13.
17.16 We provisionally propose that (in addition to the freeholder) it should be possible for leaseholders who are in the process of acquiring the freehold by collective enfranchisement, to apply to HM Land Registry to create a new commonhold.

Do consultees agree?

17.17 We provisionally propose that, where a lender has consented to a conversion to commonhold on the condition that it will be granted new security over the commonhold unit after conversion, a deed of substituted security provided to HM Land Registry will act as sufficient evidence that this condition has been fulfilled.

Do consultees agree?

Paragraph 4.49
Consultation Question 14.
17.18 Where the freehold of the building is owned by the leaseholders collectively through a freehold management company (a “FMC”), we provisionally propose that the common parts of the building should be transferred to a new commonhold association as part of the process of conversion to commonhold (rather than the FMC changing its articles to become a commonhold association, where this is possible).

Do consultees agree?

Paragraph 4.59

Consultation Question 15.
17.19 We invite consultees’ views as to whether, taking into account our provisional proposals set out in questions 11 to 14, the conversion procedure would operate satisfactorily.

17.20 We invite consultees’ view on what changes could be made to simplify the procedure and make it more cost-effective.

Paragraph 4.61
Consultation Question 16.
17.21 We provisionally propose that any new management structure needs to meet the following objectives:

(1) Provide the ability to separate out the management of a variety of different interests within the same development, in particular by:
   (a) differentiating voting rights, so that those affected by a decision are entitled to participate in making that decision, and no one else is able to do so; and
   (b) allowing shared costs to be allocated in different ways to ensure that only those benefitting from a service pay for it.

(2) Provide a framework which can be used to regulate the relationship between more than one building where there are shared areas, such as shared car parks or gardens.

(3) Strike an appropriate balance between standardisation and flexibility.

(4) Facilitate consumer protection to ensure that abuses that have arisen in the residential leasehold context cannot be transposed into commonhold.

Do consultees agree?

17.22 Are there any other objectives which should be added to the list above?

Paragraph 5.15

Consultation Question 17.
17.23 We provisionally propose that commonholds with sections (which are not individual corporate bodies) should be introduced as a management structure to make commonhold workable for more complex developments.

Do consultees agree?

17.24 If consultees do not agree, do consultees prefer either the flying commonhold model or layered commonhold model? If so, how do consultees suggest addressing the issues with these models?

17.25 Are consultees aware of any other options we should be considering?

Paragraph 5.55
Consultation Question 18.

17.26 We provisionally propose that it should be optional, rather than mandatory, for a section committee to be set up for each section in a commonhold. Do consultees agree?

17.27 If consultees disagree, which powers do consultees think should be given compulsorily to those committees?

Paragraph 5.71

Consultation Question 19.

17.28 We invite consultees’ views as to whether delegation to section committees should be collateral or exclusive; whether this should vary for different powers; or whether it should be for each commonhold to decide.

Paragraph 5.78

Consultation Question 20.

17.29 We invite consultees’ views as to whether:

1. directors should be able to revoke or alter the powers delegated to a section committee as they wish;

2. section committees affected by an alteration of delegated powers should be given the ability to apply to the Tribunal; or

3. the directors should have to apply to the Tribunal in order to alter or revoke a delegation.

Paragraph 5.81
Consultation Question 21.

17.30 We provisionally propose that a new section should be able to be created by:

(1) the developer, at the outset; and

(2) the commonhold association at a later date.

Do consultees agree?

17.31 If the commonhold association is allowed to create sections after it has been set up, we provisionally propose that this decision should be approved by special resolution, with the additional requirement that at least 75% of the total votes held by the unit owners who would be part of the new section must have been cast in favour of creating the section.

Do consultees agree?

17.32 We provisionally propose that unit owners affected by the introduction of a new section should be given the option of applying to the Tribunal.

Do consultees agree?

Paragraph 5.88

Consultation Question 22.

17.33 We provisionally propose that qualifying criteria for sections should be introduced, so that sections can only be created to give separate classes of vote to:

(1) residential and non-residential units;

(2) non-residential units, which use their units for significantly different purposes;

(3) different types of residential units (such as flats and terraced houses);

(4) separate blocks in the same development; and

(5) other premises falling within the commonhold which, in the interests of practicality and fairness, should form a separate section.

Do consultees agree? Are there any other criteria which consultees feel should be added to the list?

Paragraph 5.94
**Consultation Question 23.**

17.34 We provisionally propose that it should be possible for sections to consist of a single unit.

Do consultees agree?

**Paragraph 5.96**

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**Consultation Question 24.**

17.35 We provisionally propose that to combine two or more sections, a special resolution of the commonhold association should be required. Additionally, 75% of the votes cast by the unit owners in the sections that are to be combined must have been in favour.

Do consultees agree?

17.36 We provisionally propose that unit owners affected by sections being combined should be given the right to apply to the Tribunal as an additional protection.

Do consultees agree?

17.37 We provisionally propose that there should be no criteria which must be met before two or more sections in a commonhold can be combined.

Do consultees agree?

**Paragraph 5.101**

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**Consultation Question 25.**

17.38 We invite consultees’ views as to whether statutory development rights should apply automatically so as to avoid the need to reserve express rights in the CCS.

17.39 We invite consultees’ views as to whether such statutory rights should be drawn widely to include all matters which are likely to apply in commonhold developments, including (but not limited to) the right to add land, to make consequential variations to commonhold contributions and voting rights, and rights of access.

**Paragraph 6.65**
Consultation Question 26.
17.40 We provisionally propose that there should be no specific statutory provisions for the appointment of developers’ directors. Instead, a developer’s ability to appoint directors should depend on the number of units it retains.

Do consultees agree?

17.41 We provisionally propose that developers should be able to exercise all voting rights associated with the units of which they are the registered owners.

Do consultees agree?

Paragraph 6.67

Consultation Question 27.
17.42 Currently, the Commonhold Regulations place certain restrictions on a developer’s exercise of development rights:

(1) the developer must not exercise rights in a way which would interfere unreasonably with unit owners’ enjoyment of their units or their ability to exercise rights granted by the CCS;

(2) the developer may not remove land from the commonhold which forms part of a unit unless the owner of that unit provides written consent;

(3) any damage caused to the commonhold land by the developer should be remedied as soon as reasonably practicable; and

(4) the developer may not exercise development rights if the works for which the right was granted have been completed (excluding the developer’s right to market units).

17.43 We invite consultees’ views as to whether any further restrictions should be introduced on the use of development rights: in particular, whether a time limit should be imposed on the exercise of these rights (and if so, what this time limit should be).

Paragraph 6.69
Consultation Question 28.
17.44 We provisionally propose that “anti-avoidance” provisions should be introduced to ensure that the developer does not attempt to secure a greater degree of control by:

(1) taking powers of attorney from the purchasers (or seeking to control votes in any other way); or

(2) attempting to control how unit owners vote by inserting terms in the purchase contracts.

Do consultees agree?

Paragraph 6.71

Consultation Question 29.
17.45 We invite consultees’ views as to what advantages there are (if any) of the transitional period in the registration procedure for new commonhold developments.

Paragraph 6.72

Consultation Question 30.
17.46 We invite consultees’ views as to whether any requirements of company law (such as to make an annual confirmation statement, and to file accounts) should be relaxed for commonhold associations.

Paragraph 7.67

Consultation Question 31.
17.47 We invite consultees’ views as to whether there are particular difficulties in applying CVAs to commonhold associations.

17.48 We invite consultees’ views as to whether the CVA procedure needs any adaptations to make it more relevant and effective in dealing with commonhold associations in financial difficulties.

Paragraph 7.68
Consultation Question 32.

17.49 We provisionally propose that it should not be possible for creditors directly to petition for a commonhold association to be wound-up, and a liquidator appointed. Instead, a petition could lead to the court appointing a commonhold administrator, who would carry out the necessary duties.

Do consultees agree?

17.50 We provisionally propose that a commonhold administrator should then be able to petition for the association to be wound-up only if the commonhold association is irretrievably insolvent.

Do consultees agree?

Paragraph 7.70

Consultation Question 33.

17.51 We provisionally propose that the law should be clarified to ensure that there is a presumption that, on the insolvency of a commonhold association, a successor association should usually be appointed.

Do consultees agree?

17.52 We invite consultees’ views as to whether there are circumstances in which it would not be appropriate for the court to appoint a successor association and, if so, what these circumstances are.

17.53 We provisionally propose that the court should have discretion as to whether to impose conditions for a successor association to be appointed.

Do consultees agree?

17.54 We invite consultees’ views as to:

(1) what conditions might be imposed; and

(2) if the court’s discretion is to be structured, what factors the court should take into account.

Paragraph 7.72
**Consultation Question 34.**

17.55 We provisionally propose that, if a liquidator is appointed to wind up a commonhold association, he or she should not be able to demand further contributions from the unit owners to reduce the level of indebtedness of the association.

Do consultees agree?

17.56 We provisionally propose that, if a liquidator is appointed to wind up a commonhold association, he or she should not be able to demand further contributions from the unit owners to make up for the shortfall in contributions from members who are bankrupt or from whom it is impossible to recover their contributions.

Do consultees agree?

**Paragraph 7.76**

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**Consultation Question 35.**

17.57 We provisionally propose that it should be possible for the CCS to impose restrictions on the short-term letting of units.

Do consultees agree?

17.58 We invite consultees’ views as to how to ensure that any restriction on short-term letting does not prevent units being rented in the private or social rented sector. In particular:

(1) in relation to the private rented sector, we invite views on whether any restriction imposed by a CCS should be confined to lettings made for less than six-months, or for any other specified period;

(2) in relation to the social rented sector, we invite views on whether any restriction imposed by a CCS should not be able to apply to particular landlords, such as registered providers of social housing and housing associations, or whether there are other ways of ensuring that such lettings cannot be prohibited in the CCS.

**Paragraph 8.35**
Consultation Question 36.

17.59 We provisionally propose that event fees should be prohibited within commonhold, except for any specific circumstances expressly permitted by statute.

Do consultees agree?

17.60 We invite consultees’ views as to whether an exception to the proposed prohibition on event fees should be made for specialist retirement properties within commonhold.

17.61 We invite consultees’ views as to whether there are any other circumstances (apart from specialist retirement properties) in which event fees should be permitted within commonhold.

Paragraph 8.43

Consultation Question 37.

17.62 We invite consultees’ views as to whether any further restrictions should be put in place to limit which local rules may be added to the CCS.

Paragraph 8.47

Consultation Question 38.

17.63 We provisionally propose that a higher threshold for amending the CCS should be introduced, which may apply to some or all local rules.

Do consultees agree?

17.64 We invite consultees’ views as to:

(1) what voting threshold should be required to amend local rules;

(2) when there should be a right to apply to the Tribunal in relation to amendments of the CCS; and

(3) whether the threshold should be the same for amending all local rules, or whether rules should be differentiated. If consultees are of the view that rules should be differentiated, we invite views as to how the threshold for introducing a rule in an area on which the CCS is currently silent should be determined.

Paragraph 8.68
Consultation Question 39.
17.65 We provisionally propose that the mandatory provisions of the CCS should be contained in the regulations, but not be reproduced in the CCS.

Do consultees agree?

17.66 If so, we invite consultees’ views as to whether the directors of the commonhold association should be under a duty to provide copies of the most up-to-date standard provisions contained in the regulations, along with a copy of the CCS, to any new purchasers, and should provide copies of the updated standard provisions to all unit owners as and when changes are made.

Paragraph 8.77

Consultation Question 40.
17.67 Should our provisional proposals to introduce sections be implemented, we provisionally propose that it should be possible to add schedules to the CCS, where the rights and obligations applying to a specific section can be collated.

Do consultees agree?

Paragraph 8.80

Consultation Question 41.
17.68 We invite consultees’ views as to whether there are any new terms, other than those we have asked about in this Consultation Paper, which should be added to the prescribed terms of the CCS (that is, rules which should apply to every commonhold, rather than local rules which can optionally be adopted by individual commonholds).

Paragraph 8.83
Consultation Question 42.

17.69 We provisionally propose that the procedure for the election of directors of a commonhold should be simplified, so that the prescribed articles of association provide that directors should be elected at a general meeting, and also may be co-opted by the existing directors.

Do consultees agree?

Paragraph 9.32

Consultation Question 43.

17.70 We provisionally propose that, if a commonhold association cannot find members able and willing to serve as directors, and is also unwilling to appoint professional directors, any member of the association should be able to apply to a court or tribunal for professional directors to be appointed, who would then be paid by the association.

Do consultees agree?

17.71 We provisionally propose that, if members should be able to make such an application, then someone with a mortgage or other charge over a unit should also be able to do so.

Do consultees agree?

17.72 We provisionally propose that, if it should be possible for an application to appoint directors to be made, it should be heard by the First-tier Tribunal (Property Chamber) (in Wales, the Residential Property Tribunal).

Do consultees agree?

Paragraph 9.36
**Consultation Question 44.**

17.73 We invite consultees’ views as to whether a problem is likely to arise whereby a single investor, or a group of investors, who own a majority of units, run a block in their own interests in order to “squeeze out” other owners.

17.74 If it is felt that problems are likely to arise, then we invite consultees’ views as to the following:

1. whether the concept of “persistent failure to comply with the CCS in some material respect”, offers a satisfactory basis upon which a court or tribunal could intervene on an application by a unit owner;
2. whether such applications should be made to the court or the Tribunal;
3. whether, the court or Tribunal should have the power to appoint directors, and to make the supplementary orders set out in paragraph 9.48 above, should they be required;
4. whether it would be necessary for the court or tribunal to exercise continuing supervision over the directors who were appointed; and
5. whether other solutions could be used to address the difficulty.

Paragraph 9.51

**Consultation Question 45.**

17.75 We seek consultees’ views on whether their experience with other leaseholder-controlled companies (Freehold Management Companies, Residents’ Management Companies and right to manage companies) leads them to believe that provisions for proxy voting may be abused, and, if so, in what way or ways.

17.76 We further seek consultees’ views on whether any such abuses could be prevented or mitigated by:

1. a restriction on the number of proxy votes that any individual might hold; or
2. some other device (please specify).

Paragraph 9.58
Consultation Question 46.

17.77 We provisionally propose that legislation should deem that the commonhold association has an insurable interest in the parts of the building which are owned by the unit owners.

Do consultees agree?

17.78 We provisionally propose that legislation should require the commonhold association to reinstate or rebuild (as appropriate) the whole of a horizontally-divided building – including the parts owned by the unit owners – in order to satisfy the indemnity principle within insurance law.

Do consultees agree?

17.79 We invite consultees' views as to whether any other legal difficulties would arise in arranging buildings insurance for commonholds which have not been addressed by these proposals.

Paragraph 9.87

Consultation Question 47.

17.80 We provisionally propose that the CCS should be amended so as to require that either a copy of the buildings policy and schedule, or sufficient details of it, should be supplied to all unit owners on or before they acquire a unit, and whenever the terms of the policy change.

Do consultees agree?

17.81 We provisionally propose that the commonhold association should confirm to unit owners and their mortgage lenders that the insurance is in existence on an annual basis, and when reasonably required at other times.

Do consultees agree?

Paragraph 9.90
Consultation Question 48.
17.82 We invite consultees’ views as to whether public liability insurance (that is, insurance against liability as an occupier and also as a property owner) is likely to be generally available for commonhold associations.

17.83 If it is generally available, we provisionally propose that details of minimum cover, permissible exclusions and excesses, and so on, should be prescribed in regulations to be made by the Secretary of State.

Do consultees agree?

Paragraph 9.93

Consultation Question 49.
17.84 We provisionally propose that the commonhold community statement should contain an express power for the commonhold association to take out directors’ and officers’ insurance.

Do consultees agree?

Paragraph 9.96
Consultation Question 50.

17.85 We provisionally propose that the provisions in the prescribed commonhold community statement requiring the repair of the common parts should be extended to require also “renewals”; that is, the replacement of “like with like” if something should be beyond economic repair.

Do consultees agree?

17.86 We provisionally propose that the installation of adequate thermal insulation should be deemed to be a repair.

Do consultees agree?

17.87 We provisionally propose that it should be possible for the repairing obligations required by the CCS to be supplemented by a local rule requiring a higher standard of repair, if appropriate.

Do consultees agree?

17.88 We provisionally propose that, with horizontally-divided buildings (so including all flats), matters relating to the internal repair of units should be left to local rules.

Do consultees agree?

17.89 We provisionally propose that with vertically-divided buildings (that is, all houses, whether detached, semi-detached or terraced) all matters relating to repair (whether internal or external) of the units should be left to local rules.

Do consultees agree?

Paragraph 9.111
**Consultation Question 51.**

17.90 We invite consultees’ views as to whether rights of entry are best left to local rules, or whether rights of entry should be prescribed.

17.91 If rights of entry are prescribed, we invite consultees’ views as to whether it is necessary to make a distinction between different types of buildings.

17.92 If it is necessary to distinguish between different types of building, we invite consultees’ views as to:

1. whether the distinction should be between those that are horizontally-divided, and those that are vertically-divided; and
2. if some other distinction is more appropriate, what that should be.

17.93 We invite consultees’ views as to what, in each case, the appropriate rights of entry would be.

*Paragraph 9.128*

**Consultation Question 52.**

17.94 We provisionally propose that the commonhold community statement should be amended to provide that alterations to the common parts which are incidental to internal alterations made by a unit owner to his or her own unit should not require the consent of the members by an ordinary resolution.

Do consultees agree?

17.95 We provisionally propose that the giving of consent to such proposals should be delegated to the directors.

Do consultees agree?

17.96 We invite consultees’ views as to whether:

1. “minor alterations to the common parts” should be defined as we have outlined at paragraph 9.137 above; or
2. some other criterion could be adopted to distinguish minor alterations from those which should continue to require the consent of an ordinary resolution by the members.

*Paragraph 9.139*
Consultation Question 53.

17.97 We invite consultees’ views as to whether existing long-term contracts have been a problem which leaseholders have encountered.

17.98 If they have, then we further invite leaseholders to let us have examples.

Paragraph 9.152

Consultation Question 54.

17.99 We provisionally propose that commonhold associations should be given the right, within a set period from the date when the unit owners take effective control of the commonhold association, to cancel contracts which were entered into by the association before that date. (It would be necessary to define these terms so as to exclude the scenario where the units were “sold” to associates of the developer).

Do consultees agree?

17.100 We provisionally propose that a “long-term contract” should be defined as a contract which must run for more than 12 months.

Do consultees agree? If not, what longer or shorter period would be appropriate?

17.101 We provisionally propose that a commonhold association should have to exercise this right within six months from the commonhold coming under the effective control of the unit owners (being actual “arms-length” purchasers of the units).

Do consultees agree? If not, what longer or shorter period would be appropriate?

Paragraph 9.154

Consultation Question 55.

17.102 We invite consultees’ views as to the difficulties that can arise when the long-term contract includes the hire of equipment which remains the property of the contractor and which they have reserved the right to remove if the contract should be terminated. We would appreciate any examples of contracts involving the hire of equipment, or of long-term contracts generally, that consultees are able to provide.

Paragraph 9.157
Consultation Question 56.

17.103 We provisionally propose that the proposed contributions to shared costs should require the approval of the members of the commonhold association. This approval would generally be given by a resolution passed in a general meeting, though it could be passed by the written procedure.

Do consultees agree?

17.104 We provisionally propose that this approval should be given by an ordinary resolution (over 50% majority), rather than by a special resolution (at least 75% majority).

Do consultees agree?

17.105 We invite consultees' views as to the suggestion that if the proposed level of contributions failed to secure approval, the level of contributions required in the previous financial year should continue to apply.

17.106 We invite consultees' alternative proposals to address the issue of what should happen if the directors' proposed level of commonhold contributions fail to obtain approval.

Paragraph 10.35
Consultation Question 57.

17.107 We provisionally propose that it should be possible for the CCS to include, as a local rule, an index-linked “cap” on the amount of expenditure which could be incurred on the cost of improvements.

Do consultees agree?

17.108 We provisionally propose that it should be possible for the CCS to include, as a local rule, an index-linked “cap” on the amount of expenditure which could be incurred annually on the cost of “enhanced services”, as described in paragraph 10.40(1).

Do consultees agree?

17.109 We provisionally propose that if a CCS contained such a “cap”, then it could be removed only with the unanimous consent of the unit owners, or with the support of 80% of the available votes, and the approval of the Tribunal.

Do consultees agree?

17.110 We provisionally propose that any application by a unit owner to challenge proposed expenditure should be made before it was incurred, and expenditure should not be open to challenge later.

Do consultees agree?

Paragraph 10.41
Consultation Question 58.

17.111 We provisionally propose that it should be compulsory for a commonhold association to have some form of reserve fund.

Do consultees agree?

17.112 We provisionally propose that the scheme for the financing of the commonhold should continue to distinguish between contributions for shared (current) expenditure, and contributions to the reserve fund or funds.

Do consultees agree?

17.113 We provisionally propose that no minimum annual contribution towards the reserve fund should be specified.

Do consultees agree?

17.114 We invite consultees who do not agree to suggest how a requirement for minimum contributions might operate.

17.115 We provisionally propose that the directors of commonhold associations should be able to set up such designated reserve funds as they see fit.

Do consultees agree?

17.116 We provisionally propose that it should also be possible for the members of a commonhold association to require, by ordinary resolution, that a designated reserve fund or funds should be set up.

Do consultees agree?

17.117 We provisionally propose that designated reserve funds should be protected from enforcement action by creditors, unless their claim relates to the specific purpose for which the designated reserve fund was set up.

Do consultees agree?

17.118 We provisionally propose that designated reserve funds should continue to receive equivalent protection if the commonhold association should be subject to insolvency proceedings.

Do consultees agree?

17.119 We provisionally propose that it should be possible to change the designation of a designated reserve fund only by a resolution supported by 80% of the members, and with the approval of the Tribunal.

Do consultees agree?
17.120 We invite consultees’ views as to whether the directors (or the members in a general meeting) should be able to “borrow” from a reserve fund in order to meet a shortfall in meeting other expenditure, and, if so, what safeguards, if any, would be appropriate.

17.121 We provisionally propose that the proposed annual contributions to the reserve fund or funds should be approved by the members in the same way as the contributions to current expenditure, and, if possible, at the same time.

Do consultees agree?

Paragraph 10.71

Consultation Question 59.

17.122 We provisionally propose that it should be possible to allocate to individual units within a commonhold different percentages that it must contribute towards different “heads” of cost.

Do consultees agree?

17.123 We invite consultees’ views as to whether each commonhold should have total flexibility in how different costs are allocated, or whether there should be any limitations on their ability to do so.

Paragraph 10.96
Consultation Question 60.

17.124 We provisionally propose to retain the possibility of varying the percentage of expenditure allocated to each unit, by amending the CCS by special resolution. Such amendments would remain subject to a unit owner’s right not to have a significantly disproportionate amount of the contributions to shared costs, or the reserve funds, allocated to his or her unit.

Do consultees agree?

17.125 We invite consultees’ views as to whether:

(1) it is likely to be fair and workable to consider any proposed variations to contributions to shared costs, and the reserve funds, on the basis that the originally allocated percentage was fair; and

(2) safeguards need apply only if the allocated percentage is altered.

17.126 We invite consultees’ views as to whether internal floor area would offer a satisfactory default basis on which to allocate financial contributions in purely residential commonholds.

17.127 We invite consultees’ views as to whether internal floor area would offer a satisfactory default basis on which to allocate financial contributions in commonholds which include (a) commercial and residential units and (b) commercial units of different kinds. If not, we invite views on alternative methods.

Paragraph 10.100
Consultation Question 61.

17.128 We provisionally propose that the current scheme for the issue of a Commonhold Unit Information Certificate (“CUIC”) on the sale of a unit should in its essentials be retained.

Do consultees agree?

17.129 We invite consultees’ views as to whether the possibility of further contributions (emergency contributions, or contributions to the reserve fund or funds) falling due after the issue of a CUIC is likely to present practical problems to conveyancers.

17.130 We provisionally propose that, once a CUIC has been issued, an incoming unit owner should not be liable for further contributions which fall due, unless the commonhold association or its agent has notified the current owner’s conveyancers of the further liabilities.

Do consultees agree?

17.131 We provisionally propose that the maximum fee for a commonhold association to issue a CUIC should be set by regulation, and kept under review.

Do consultees agree?

17.132 We invite consultees’ views as to whether the lack of any sanction or convenient remedy for the failure on the part of the commonhold association to issue a Commonhold Unit Information Certificate within the prescribed 14-day period is likely to cause problems in practice.

17.133 We further invite consultees’ views on how best this may be resolved.

17.134 We invite consultees’ views as to whether a Commonhold Unit Information Certificate should be conclusive once issued; or whether it should be possible for it to be amended if an error is spotted after it has been issued.

17.135 We further invite consultees’ views on what problems would arise in practice if a Commonhold Unit Information Certificate could be amended; and on how these might be addressed.

Paragraph 10.118
Consultation Question 62.

17.136 We invite consultees’ views as to whether the need for unit owners to obtain the consent of their mortgage lender to support the commonhold association granting a fixed or floating charge is likely to be a significant difficulty in raising emergency funding.

17.137 If consultees consider that there might be difficulties, we invite views on what measures could be put in place to alleviate these difficulties, including whether the Tribunal should be able to override a mortgage lender’s refusal to give consent.

Paragraph 11.28

Consultation Question 63.

17.138 We provisionally propose that express provision should be made for a commonhold association to grant a floating charge.

Do consultees agree?

17.139 We provisionally propose that a charge over the common parts or a floating charge should only be able to be granted when either:

(1) The unit owners unanimously consent to the charge: or

(2) 80% of the unit owners consent to the charge, and approval is obtained from the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal Wales.

Do consultees agree?

Paragraph 11.36

Consultation Question 64.

17.140 We provisionally propose that it should be possible for a commonhold association (having obtained the requisite consent) to grant a charge over part of the common parts. Where such a charge is granted, the part of the common parts so charged may be registered with a separate title number.

Do consultees agree?

Paragraph 11.40
**Consultation Question 65.**

17.141 We provisionally propose making an exception to the prohibition on residential leases over seven years, and leases granted at a premium, for shared ownership leases which contain the fundamental clauses prescribed by Homes England in England or the Welsh Government in Wales.

Do consultees agree?

**Paragraph 12.30**

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**Consultation Question 66.**

17.142 We provisionally propose that in new commonhold developments, the model shared ownership lease should require the shared ownership leaseholder to comply with all terms of the CCS.

Do consultees agree?

17.143 We provisionally propose that shared ownership leaseholders in new commonhold developments should be able to exercise all the votes of the commonhold association in place of the shared ownership provider, apart from a decision to terminate, which should be exercised jointly with the provider.

Do consultees agree?

17.144 We provisionally propose that shared ownership leaseholders in new commonhold developments should not have the same statutory rights as other leaseholders to challenge service charge costs or to be consulted on works and contracts exceeding a certain amount.

Do consultees agree?

17.145 We provisionally propose that, in new commonhold developments, on purchasing 100% of the value of the commonhold unit, the shared ownership leaseholder should be transferred the commonhold title of the unit and should become a member of the commonhold association.

Do consultees agree?

**Paragraph 12.44**
Consultation Question 67.

17.146 We provisionally propose that in a building which has converted to commonhold, the shared ownership provider should have voting rights in the commonhold association. Delegation of voting rights to the shared owner will be possible on a voluntary basis, but not mandatory.

Do consultees agree?

17.147 We provisionally propose that, in a building which has converted to commonhold, the staircasing provisions of any existing shared ownership leases should continue to operate in the same way. On staircasing to 100%, the shared owner will therefore remain a leaseholder.

Do consultees agree?

17.148 We provisionally propose that after having staircased to 100% of the value of the leasehold flat, the shared ownership leaseholder should have a statutory right to purchase the commonhold unit and become a member of the commonhold association.

Do consultees agree?

Consultation Question 68.

17.149 We invite consultees’ views as to whether an exception to the ban on residential leases over seven years is needed to accommodate better community land trusts and co-operatives within the commonhold model.

Consultation Question 69.

17.150 Aside from shared ownership leases, community land trusts and housing co-operatives, are consultees aware of any other forms of affordable housing which it is not possible, or would be difficult, to accommodate in the current commonhold system?
Consultation Question 70.
17.151 We provisionally propose that an exception to the prohibition on residential leases of over seven years or granted at a premium should be made for lease-based home purchase plans regulated by the Financial Conduct Authority.

Do consultees agree?

Paragraph 12.79

Consultation Question 71.
17.152 We provisionally propose that customers of lease-based home purchase plans in new commonhold developments should not have the same statutory rights as other leaseholders to challenge service charge costs or to be consulted on works and contracts exceeding a certain amount.

Do consultees agree?

Paragraph 12.84

Consultation Question 72.
17.153 We ask consultees for their views and experience of how the relationship between a bank and a customer who is purchasing property through a lease-based home purchase plan is, or can be, preserved following a collective enfranchisement.

Paragraph 12.89

Consultation Question 73.
17.154 We provisionally propose that the commonhold association should not be able to prevent a unit owner or tenant from pursuing direct legal action against another unit owner or tenant. Instead, the association should have the right to notify the unit owner or tenant that it reasonably considers the claim to be frivolous, vexatious or trivial or that the matter complained of is not a breach of the CCS.

Do consultees agree?

Paragraph 13.26
Consultation Question 74.
17.155 We provisionally propose that a failure to use the forms which accompany the commonhold dispute resolution procedure, or forms to the same effect, should not automatically prevent a claim from progressing.

Do consultees agree?

Paragraph 13.32

Consultation Question 75.
17.156 We provisionally propose that referral to an ombudsman should not be a mandatory part of commonhold’s dispute resolution procedure. Instead, it could be used on an optional basis, instead of, or alongside, other forms of alternative dispute resolution.

Do consultees agree?
17.157 We provisionally propose that membership of an approved ombudsman scheme should no longer be a requirement for commonhold associations, and that, instead, commonhold associations should be able to decide whether or not to become a member of an ombudsman scheme.

Do consultees agree?

Paragraph 13.52

Consultation Question 76.
17.158 We provisionally propose that, where the dispute resolution procedure has not been followed, any court or tribunal, which subsequently considers the dispute, should have full discretion to disregard the non-compliance, or to order the parties to take any steps it considers appropriate, in accordance with its general case management powers.

Do consultees agree?

Paragraph 13.56
Consultation Question 77.
17.159 We invite consultees’ views as to whether the current commonhold dispute resolution procedure should be transferred to a pre-action protocol.

Paragraph 13.67

Consultation Question 78.
17.160 We provisionally propose that the jurisdiction of the First-tier Tribunal (Property Chamber) in England and the Residential Property Tribunal Wales should be extended to cover disputes arising within a commonhold.

Do consultees agree?

Paragraph 13.76

Consultation Question 79.
17.161 We invite consultees’ views as to whether the prescribed CCS should include a provision that, where a unit owner or tenant breaches the rules of the CCS, the unit owner, or tenant, should be required to indemnify the other unit owners and the commonhold association for any losses they reasonably incur as a result of the breach.

Paragraph 13.82
Consultation Question 80.

17.162 Elsewhere in this Consultation Paper we provisionally propose that it should be possible for a unit owner (or owners) to apply to the First-tier Tribunal (Property Chamber) in England or the Residential Property Tribunal Wales to challenge a decision of the commonhold association in the following circumstances:

(1) Where the commonhold association approves a budget, which will result in costs above a threshold (set in the CCS) being incurred on works or enhanced services;

(2) Where the minority are outvoted on a decision to vary the local rules of the CCS;

(3) If the directors of the association delegate powers to a committee which has been set up to represent a section of the commonhold, and the unit owners in the section wish to prevent the directors revoking or amending these powers;

(4) Where the unit owner, or owners, are opposed to the introduction of a new section or the combination of two or more sections.

17.163 We invite consultees’ views as to whether there are any other circumstances in which it would be appropriate to provide a unit owner (or owners) with a right to challenge a decision taken by the commonhold association.

Paragraph 13.90
Consultation Question 81.

17.164 We invite consultees’ views as to the extent to which the following factors should be taken into account by the First-tier Tribunal (Property Chamber) and the Residential Property Tribunal Wales when deciding whether or not to grant a remedy to a unit owner who challenges a decision taken by the commonhold association:

(1) Whether or not the unit owner(s) making the application voted against the decision complained of, or had a good reason for not doing so.

(2) Whether the decision complained of needs to have a particular impact on the unit owner (or owners) and if so, what degree of impact.

(3) The reason behind the decision taken by the commonhold association, for example, whether the decision is in the best interests of the commonhold and/or is proportionate to the impact on the unit owner in question.

17.165 We also invite consultees’ views on whether the same factors would be relevant in all of the circumstances set out in Consultation Question 80 where a unit owner may have the right to apply to the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal (Wales).

Paragraph 13.95

Consultation Question 82.

17.166 We provisionally propose that on an application by a unit owner challenging a decision of the commonhold association, the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal (Wales) should be able to allow the decision to stand or annul the decision. If the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal (Wales) allows the decision to stand, we propose that the Tribunal should be able to attach conditions to its decision.

Do consultees agree?

Paragraph 13.98
Consultation Question 83.
17.167 We invite consultees’ views as to whether the commonhold association should be provided with enhanced powers to address non-financial breaches of the CCS.

If so, what should these powers be?

Paragraph 14.31

Consultation Question 84.
17.168 We provisionally propose that a statutory cap should be introduced on the rate of interest which may be charged by the commonhold association on late payments of commonhold contributions.

Do consultees agree?

Paragraph 14.44

Consultation Question 85.
17.169 We provisionally propose that a commonhold association should have an automatic statutory charge over commonhold units for the payment of commonhold costs.

Do consultees agree?

17.170 We provisionally propose that if the commonhold association has an automatic statutory charge over commonhold units for the payment of commonhold contributions, this charge should take priority over all other charges (such as a mortgage over the property).

Do consultees agree?

Paragraph 14.59
Consultation Question 86.

17.171 We provisionally propose that, before taking action to enforce a charge over a commonhold unit, the commonhold association should be required to follow a pre-action protocol. We envisage that the protocol will require the association to provide prescribed information to the defaulting unit owner and make reasonable attempts to agree a repayment plan.

Do consultees agree?

17.172 We invite consultees’ views as to what steps the association should be required to take as part of this protocol.

17.173 We provisionally propose that where the commonhold association wishes to enforce a charge over a commonhold unit by selling the unit, it should always be necessary for the association to apply to court for an order for sale.

Do consultees agree?

17.174 We provisionally propose that the court should only be able to order the sale of a unit where the amount owing to the commonhold association exceeds a certain amount.

Do consultees agree?

17.175 We invite consultees’ views as to what this amount should be and on what factors the court should take into account when deciding whether to order the sale of a unit.

17.176 We provisionally propose that where the sale of a unit is ordered, the court should appoint a receiver to sell the unit and distribute the proceeds of sale.

Do consultees agree?

17.177 We provisionally propose that where a receiver is appointed to sell a commonhold unit, the receiver should distribute the proceeds of sale in the following way.

(1) The receiver should be paid his or her costs of arranging the sale of the property.

(2) The commonhold association should be repaid any outstanding amounts of commonhold contributions, plus any interest and costs awarded by the court.

(3) Any other party who has an interest secured against the unit, such as a mortgage lender, should be repaid.

(4) Any remaining amount should then be returned to the defaulting unit owner.
Do consultees agree?

17.178 We provisionally propose that any tenancies granted out of a unit should continue to exist following an order for sale.

Do consultees agree?

Paragraph 14.61
Consultation Question 87.

17.179 We provisionally propose that voluntary termination of a commonhold should be possible with either:

(1) unanimous support; or

(2) the support of 80% of the available votes plus the approval of the court.

Do consultees agree?

17.180 We provisionally propose that on an application for voluntary termination the court should have discretion to decide whether to allow the voluntary termination to take place, as well as the terms on which it may do so.

Do consultees agree?

17.181 If the court has discretion as to whether to allow voluntary termination, we invite consultees' views as to the following issues:

(1) whether it would be useful to include factors to guide the court's discretion;

(2) whether the factors mentioned in paragraph 15.52 should be taken into account;

(3) whether the court should be directed to consider the amount of support there is for voluntary termination over and above the 80% required; and

(4) whether others should also be included.

17.182 We invite consultees' views as to whether increasing the role of the court would sufficiently address the issue of the final terms of the termination statement not being acceptable to those who supported the termination resolution.

17.183 We provisionally propose that an application for voluntary termination should be heard by the court (rather than by the First-tier Tribunal (Property Chamber), or in Wales the Residential Property Tribunal Wales).

Do consultees agree?
Consultation Question 88.
17.184 We provisionally propose that where a commonhold is divided into sections, any vote on voluntary termination would need to be taken in sections, and whether it was unanimous or received at least 80% support would have to be determined by section.

Do consultees agree?

17.185 Where a commonhold is not divided into sections, we provisionally propose that it should be possible for part of the commonhold to be reconstituted following voluntary termination.

Do consultees agree?

17.186 We provisionally propose that reconstitution should require 100% support of the unit owners in the part to be reconstituted, or at least 80% support and an application to the court.

Do consultees agree?

Paragraph 15.93

Consultation Question 89.
17.187 We provisionally propose that if any statute provides that a landlord should be entitled to recover possession of a property if he or she can prove an intention to demolish or reconstruct the building, such a requirement should also be satisfied if it can be proved that the commonhold association has that intention.

Do consultees agree?

17.188 We invite consultees’ views as to what further provision, if any, should be made to address the position of tenants on voluntary termination of the commonhold.

Paragraph 15.96
Consultation Question 90.

17.189 We provisionally propose that it should be clarified that mortgage lenders and other secured lenders will retain their secured interest in the commonhold units until the commonhold in its entirety is sold.

Do consultees agree?

17.190 We provisionally propose that mortgage lenders and other secured lenders should automatically have legal standing to make applications to the court during the termination process with a view to protecting their interests.

Do consultees agree?

17.191 We provisionally propose that it should be made clear that, if a unit is subject to negative equity, any shortfall should be met personally by the owner of the unit, and should not be covered by other unit owners.

Do consultees agree?

17.192 We invite consultees’ views as to any other ways in which the interests of mortgage lenders and other secured lenders may require protection on the voluntary termination of a commonhold.

Paragraph 15.101
Consultation Question 91.

17.193 We provisionally propose that the CCS should not be required to specify the share of the proceeds of termination that each unit owner is to receive on termination.

Do consultees agree?

17.194 We provisionally propose that it should be possible for the unit owners to specify the share of the proceeds of termination that each unit owner is to receive on termination (or some method of ascertaining it) in the CCS.

Do consultees agree?

17.195 We provisionally propose that the power to decide an application to disapply a provision in the CCS which determines the distribution of proceeds of sale on termination should lie with the Tribunal.

Do consultees agree?

17.196 We invite consultees’ views as to whether:

(1) guidance should be provided to the court or Tribunal as to how it should exercise its discretion; and

(2) if guidance should be provided, what factors the court or Tribunal should take into account.

17.197 We invite consultees’ views as to whether:

(1) the existing rules of the Insolvency Court would be adequate to deal with valuation issues which arise on the voluntary termination of a commonhold, or need to be supplemented by Commonhold Insolvency Rules;

(2) all issues involving the valuation of commonhold units on termination should be referred to the Tribunal (and, if so, whether that would cause any unnecessary delays);

(3) if valuation issues are referred to the Tribunal, the Tribunal should be able to appoint a single valuer.

17.198 We provisionally propose that, if a commonhold is substantially destroyed, but remains solvent, for the purposes of the termination statement, the units should be valued on the basis of the best estimate that can be made of their pre-damage value.

Do consultees agree?
17.199 We invite consultees’ views as to any other issues that might occur in the valuation of units if all or some of them have been partly or entirely destroyed. We also invite any suggested solutions.

**Paragraph 15.117**

**Consultation Question 92.**
17.200 We provisionally propose that if the process of voluntary termination should begin, but it should subsequently turn out that the commonhold is in fact insolvent, the same protections should be given to the assets of the individual unit owners as would have applied if the process had begun as an involuntary insolvency.

Do consultees agree?

17.201 We invite consultees’ views as to whether the value of the individual units should be preserved for the unit owners if the commonhold is substantially destroyed; and, if so, how this can be achieved.

**Paragraph 15.126**

**Consultation Question 93.**
17.202 We invite consultees’ views as to whether, and how, any aspects of our provisional proposals to reform the law of commonhold will affect the position of existing owners of commonhold units, either positively or negatively.

**Paragraph 16.6**

**Consultation Question 94.**
17.203 What advantages do you think commonhold could offer over leasehold?

**Paragraph 16.9**
Consultation Question 95.
17.204 We ask consultees to provide us with information about the time spent in reading through and considering the terms of leases of residential flats:

(1) when acting for a prospective purchaser;
(2) when acting for a prospective purchaser and mortgage lender;
(3) when acting for a mortgage lender on a re-mortgage;
(4) when some dispute arises within a leasehold block of flats as to responsibility for repairs and maintenance, calculation of the service charge, and similar disputes.

17.205 In each case we also invite consultees to give us some idea of the cost that would thereby be incurred to the client.

17.206 We further invite their views as to whether time is likely to be saved in reading through and considering the terms of the parts of the CCS which may be varied.

17.207 We invite consultees to share with us their experience of commonhold-type arrangements in other countries. Is there scope for savings of time to be made? If so, what would be the estimated time saved on a typical transaction?

Paragraph 16.12

Consultation Question 96.
17.208 We ask consultees to provide us with information about the prevalence of, and costs incurred in, disputes caused by the terms of one or more residential leases being inconsistent with the terms of another lease (or other leases) within a building or development. We further invite their views as to whether our provisional proposals for commonhold will reduce the scope for costs to be incurred in interpreting a commonhold community statement.

Paragraph 16.18
Consultation Question 97.

17.209 We ask consultees to provide us with information about the sort of difficulties that can arise owing to the difficulty in varying and updating the terms of leases:

(1) if the leases are varied as a conveyancing transaction which does not give rise to a dispute; and

(2) if the leases are varied as a result of an application to the Tribunal (whether the application was made because it was contested, or because it was the most convenient way of implementing the variation).

17.210 If you have figures – whether they relate to the costs incurred, or the amount of time spent – then please let us have them.

17.211 We further invite consultees’ views as to whether our proposals regarding the amendment of local rules by resolution of the commonhold association will reduce the costs which are incurred, when compared with the costs incurred under (1) or (2) above.

Paragraph 16.20

Consultation Question 98.

17.212 We invite consultees to provide us with information about costs generated by service charge disputes. We further invite their views as to whether, and by how much, our provisional proposals for commonhold will reduce the incidence of disputes and the costs that will be incurred in equivalent disputes over contributions to shared costs.

Paragraph 16.26

Consultation Question 99.

17.213 We invite consultees to provide us with information about costs generated when forfeiture proceedings need to be used to enforce payment of service charges. We further invite their views as to whether our provisional proposals for commonhold will reduce the costs that will be incurred if a commonhold association needs to seek an order for sale.

Paragraph 16.29
Consultation Question 100.
17.214 We invite consultees’ views as to:

(1) whether cases before tribunals are likely to prove more or less expensive than similar cases before courts; and

(2) whether (apart from service charge disputes, which we have already addressed in Consultation Question 98) there appears to be more or less scope for disputes within commonholds which result in litigation, when compared with leasehold developments.

Paragraph 16.32

Consultation Question 101.
17.215 We are provisionally proposing several new grounds upon which it would be possible for someone to make an application to the Tribunal. We invite consultees’ views as to:

17.216 what they consider that the likely impact of these will be on the number of applications made to the Tribunals; and

17.217 whether any particular proposals are likely to result in a large number of new applications being made.

Paragraph 16.34

Consultation Question 102.
17.218 We invite the views of consultees as to how any other aspects of our provisional proposals for reform of commonhold will affect the position of future owners of commonhold units, either positively or negatively.

Paragraph 16.35
Consultation Question 103.

17.219 We ask consultees to provide us with any information that they may have of:

(1) examples of planning agreements which are practicable under leasehold but which would not appear to be feasible under our reinvigorated model of commonhold; and

(2) services within leasehold developments which are being provided at the residents’ expense, but which, if the development had been set up on a commonhold basis, would have been provided, if at all, at public expense.

Paragraph 16.38

Consultation Question 104.

17.220 We ask consultees to provide us with any evidence they have of management difficulties which may arise where a leaseholder-controlled company is the landlord of (or responsible for the management of) commercial units; and whether this has affected their rental or capital value.

Paragraph 16.41

Consultation Question 105.

17.221 Which of the following statements best reflects your views on the provisional proposals in this Consultation Paper?

(1) If these proposals are adopted, then developers will be willing to use commonhold for a substantial number of developments.

(2) Even if these proposals are adopted, developers will not be willing to use commonhold unless Government introduces financial incentives for them to do so, either directly by offering financial incentives for the developers, or indirectly, by offering incentives for purchasers of commonhold units.

(3) Even if these proposals are adopted, and financial incentives are given, developers will not use commonhold for developments unless they are prohibited from selling flats on a leasehold basis and they are thus forced to use commonhold.

Paragraph 16.43
Consultation Question 106.
17.222 We invite consultees’ views as to:

(1) what issues prevent the uptake of commonhold; and

(2) what could or should be done to promote the adoption of commonhold.

17.223 We invite consultees’ views as to the extent to which the suggestions for the invigoration of commonhold set out in paragraph 16.47 above, and any other suggestions that they may make, are likely to result in commonhold being used instead of leasehold.

Paragraph 16.48

Consultation Question 107.
17.224 We invite consultees’ views as to whether a reformed commonhold regime should treat particular issues differently in England and in Wales. Consultees are welcome to share their views as to this point here, or in response to questions which we ask throughout the Consultation Paper about particular issues.

Paragraph 16.51
Appendix 1: Terms of reference

THE LAW COMMISSION: RESIDENTIAL LEASEHOLD LAW REFORM

TERMS OF REFERENCE

The project was announced in the Law Commission’s Thirteenth Programme of Law Reform and in Government’s response to its consultation Tackling unfair practices in the leasehold market.

The project will be a wide-ranging review of residential leasehold law, focusing in the first instance on reform to:

1. enfranchisement; and
2. commonhold.

The Law Commission and Government have also agreed that the project will include consideration of reform to the right to manage. The Terms of Reference for that aspect of the project will be published shortly.

In relation to enfranchisement and commonhold reform, Government has identified the following policy objectives for the Law Commission’s recommended reforms:

Generally

- to promote transparency and fairness in the residential leasehold sector;
- to provide a better deal for leaseholders as consumers;

Enfranchisement

- to simplify enfranchisement legislation;
- to consider the case to improve access to enfranchisement and, where this is not possible, reforms that may be needed to better protect leaseholders, including the ability for leaseholders of houses to enfranchise on similar terms to leaseholders of flats;
- to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise, whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests;
- to make enfranchisement easier, quicker and more cost-effective (by reducing the legal and other associated costs), particularly for leaseholders, including by introducing a clear prescribed methodology for calculating the premium (price), and by reducing or removing the requirements for leaseholders (i) to have owned their lease for two years before enfranchising, and (ii) to pay their landlord’s costs of enfranchisement;
- to ensure that shared ownership leaseholders have the right to extend the lease of their house or flat, but not the right to acquire the freehold of their house or participate in a collective enfranchisement of their block of flats prior to having “staircased” their lease to 100%; and
• to bring forward proposals for leasehold flat owners, and house owners, but prioritising solutions for existing leaseholders of houses;

Commonhold

• to re-invigorate commonhold as a workable alternative to leasehold, for both existing and new homes.

(1) ENFRANCHISEMENT

Enfranchisement covers the statutory right of leaseholders to:

• purchase the freehold of their house;
• participate, with other leaseholders, in the collective purchase of the freehold of a group of flats; and
• extend the lease of their house or flat.

The project will consider the following issues:

1. **Qualifying criteria.** The Commission will review the qualifying criteria that must be satisfied to exercise the right to enfranchise, namely:
   a. the premises that qualify for enfranchisement;
   b. the leaseholders who can exercise the rights, including the two-year ownership requirement, and the proportion of tenants required to participate in a collective enfranchisement claim;
   c. the landlords to whom the enfranchisement legislation applies; and
   d. the leases to which the enfranchisement legislation applies.

2. **Valuation.** The Commission will seek to produce options for a simpler, clearer and consistent valuation methodology. The review will include consideration of:
   a. the existing valuation assumptions;
   b. the extent to which the ground rent (including any rent review clause) should feature in the valuation;
   c. the role of yield and deferment rates and whether they could be standardised;
   d. the role of marriage value, hope value, and relativity, and the extent to which they should feature in the valuation;
   e. whether to retain different valuation bases (as currently exist for enfranchisement of houses, depending on historic rateable values);
   f. the valuation of the interest of any intermediate leaseholders.

3. **Procedure.** The Commission will consider reforms to make it easier, quicker and more cost-effective to enfranchise. The review will include consideration of:
   a. introducing a simplified enfranchisement procedure which is, so far as possible, consistent across all enfranchisement claims;
   b. the form, content, effect, service, and assignment of notices by leaseholders and landlords in the enfranchisement process;
c. how to reduce or remove the requirement for leaseholders to be responsible for landlords’ costs of responding to enfranchisement claims;
d. the nature and role of the nominee purchaser in collective enfranchisement claims;
e. giving effect to the right to enfranchise, including the conveyancing procedure, the terms of the transfer of the freehold or extended lease, leasebacks to the landlord, and the role of third-party funders (in a collective enfranchisement claim).
f. the forum for, and facilitation of, the resolution of disputes and enforcement of the statutory rights;
g. problems that arise where there are missing, incapacitated, recalcitrant, or insolvent landlords; and
h. the termination or suspension of an enfranchisement claim, and its effect.

(2) COMMONHOLD

Commonhold is a form of ownership of land which is designed to enable the freehold ownership of flats. There are various legal issues within the current commonhold legislation which affect market confidence and workability. The Commission will review those issues to enable commonhold to succeed.

The following legal issues will be considered:

1. Creation of commonhold (including conversion). The Commission will consider whether the procedure for creating and registering commonhold could be simplified and how it could be made easier for leaseholders to convert. In particular, the Commission will review whether, and if so how, it might be possible to convert to commonhold without the consent of:
   a. the freeholder; and
   b. all of the leaseholders.

2. Improving flexibility. The Commission will consider reforms to make the commonhold model more sophisticated and flexible to meet the needs of communities and developers, including:
   a. the creation of “layered” or “sub-commonholds” to deal with different parts of a commonhold scheme, especially in mixed-use developments; and
   b. allowing different costs to be shared between unit-holders in ways that will better reflect actual use of amenities and services.

3. Corporate structure. The Commission will consider whether the commonhold association, which owns and manages the common parts of the commonhold, should remain a company limited by guarantee or whether there might be a more appropriate corporate structure.

4. Shared ownership. The Commission will consider ways of incorporating shared ownership within commonhold.
5. **Developer rights and consumer protection.** Ensuring developers have sufficient power to complete the development whilst affording protection to unit-holders.

6. **Commonhold Community Statement.** The Commission will review the model CCS which sets out the rights and obligations of unit-holders and the commonhold association. In particular, the Commission will seek to ensure the CCS is flexible enough to meet the local needs of a scheme, and consider the circumstances in which it can be varied.

7. **Dispute resolution.** The Commission will consider ways of facilitating the resolution of disputes within commonhold.

8. **Enforcement powers.** The Commission will consider whether the enforcement powers of the commonhold association, for instance to enforce the payment of commonhold costs, are sufficient or whether these powers should be enhanced. The Commission will also consider whether there are sufficient safeguards in place to protect unit-holders from unreasonable demands for costs.

9. **Insolvency.** The Commission will consider whether any mechanisms could usefully be put in place to prevent a commonhold association from becoming insolvent, for instance whether it might be appropriate for an administrator to be appointed. The Commission will also consider the effect of insolvency on a commonhold association and review whether homeowners and lenders are adequately protected.

10. **Voluntary termination.** The Commission will review the procedure for the termination of a commonhold association by unit-holders and consider whether lenders’ security is adequately protected.

The project will commence with the publication of a call for evidence. Other legal problems that emerge from that call for evidence will be included in the project by agreement with Government.

The Commission’s review will complement Government’s own work to remove incentives to use leasehold, and Government’s work to address non-legal issues to re-invigorate commonhold such as education, publicity and supporting developers, lenders and conveyancers. As part of its call for evidence, the Commission will invite consultees’ views as to (i) whether, and if so how, commonhold should be incentivised or compelled, and (ii) the non-legal issues that must be addressed to re-invigorate commonhold, and report on the outcome of that consultation, without making recommendations.

Revised 20 September 2018
Appendix 2: Members of technical advisory group

TECHNICAL ADVISORY GROUP

(1) Professor Susan Bright, Oxford University
(2) Mark Chick, Bishop & Sewell
(3) Professor David Clarke
(4) Gary Cowen, Falcon Chambers
(5) Professor James Driscoll
(6) Timothy Dutton QC, Maitland Chambers
(7) Guy Fetherstonhaugh QC, Falcon Chambers
(8) Philip Rainey QC, Tanfield Chambers
(9) Laurence Target, Trowers & Hamlins LLP
(10) Dr Lu Xu, Lancaster University

OVERSEAS ADVISORY GROUP

Australia

(1) Chris Baker, Special Counsel at Hickey Lawyers, Australia
(2) Rhys Bollen, Executive Director at NSW State Insurance Regulatory Authority
(3) Dr Hazel Easthope, Associate Professor at the University of New South Wales, Sydney
(4) Dr Cathy Sherry, Associate Professor at the University of New South Wales, Sydney

Canada

(5) Prof Douglas Harris, Professor at the University of British Columbia, Peter A Allard School of Law

New Zealand

(6) Thomas Gibbons, Director at McCaw Lewis Lawyers, New Zealand
(7) Rod Thomas, Associate Professor at Auckland University of Technology, New Zealand
South Africa

(8) Professor Graham Paddock, Senior Partner at Paddocks Sectional Title Specialists, South Africa

United States of America

(9) William Breetz, Uniform Law Commission, USA

(10) Wayne Hyatt, Attorney with Hyatt & Stubblefield, P.C., USA

(11) Carl Lisman, Uniform Law Commission, USA

(12) Benjamin Orzeske, Uniform Law Commission, USA
Appendix 3: Stakeholders we spoke to whilst producing this Consultation Paper

**Representative bodies and groups**

- All-Party Parliamentary Group on leasehold and commonhold reform
- Associated Retirement Community Operators
- Association of Leasehold Enfranchisement Practitioners
- Association of Residential Managing Agents
- Association of Retirement Housing Managers
- Bar Council
- Charities’ Property Association
- Commercial Real Estate Legal Association
- Federation of Private Residents’ Associations
- Home Builders Federation
- Institute of Residential Property Management
- Law Society
- Leasehold Knowledge Partnership
- Leaseholder Association
- Residential Landlords Association
- Retirement Housing Group
- Society of Licensed Conveyancers
- UK Finance

**Firms and other organisations**

- A2 Dominion
- Age UK
- Al Rayan Bank
- Barratt PLC
- Berkeley Group
- Boodle Hatfield LLP
- Clarion Housing Group
- Coastline Housing
- Countryside
- E&M
- FirstPort
- Homeground
- Irwin Mitchell LLP
- LEASE
- Leasehold Reform Group
- Linden Homes
- Mainstay
- McCarthy & Stone
- Miller Homes
- Osborne Clark LLP
- Pinsent Masons LLP
- Places for People
- Propertymark
- Red Kite Law LLP
- Redrow Homes
- Tanfield Chambers
- The Guinness Partnership
- The Property Ombudsman
- Trowers & Hamlins LLP
- UBL
- Winckworth Sherwood LLP
- Wrigleys Solicitors LLP
Individuals

Naveen Agnihotri       C G van der Merwe       Mohammed Saqub
Katharine Fenn         Katherine O’Riordan   David Weatherall
Siobhan McGrath (President of the First-tier Tribunal (Property Chamber)) Mark Routley
Appendix 4: Call for evidence consultees

A2Dominion Housing Group Ltd
AgeUK
Alan Davis
Alan Mitchell
Alec Stanley
Alex Quinn
Andrew Hinds
Anonymous Member of the Public
Associated Retirement Community Operators ("ARCO")
Association of Residential Managing Agents ("ARMA")
Association of Retirement Housing Managers
Barbara Gardener
Barbara Thorne
Barratt Plc
Birmingham Law Society
Boodle Hatfield LLP
Bramshott Place Village Residents' Association
British Insurance Brokers’ Association
British Property Federation
Building Societies Association
Carol Carter
Carol Kerby
Catherine Margaret Charles
Catherine Tuckwood
Cecilia Yeung
Charities’ Property Association
Christine Jackson
Christopher Jessel
City of London Law Society
Cliff Barry
Coastline Housing
Colette Boughton
Commercial Real Estate Legal Association ("CRELA")
Conveyancing Association
David Brown
David Croydon
David Johnson
David McArthur
David Robinson
Dawn Barnes
Derrick Fuller-Webster
Dr C Hakim
Ellen Andrew
Emerson Group
Ernest Whittaker
Estates and Management Limited
Federation of Private Residents’ Associations ("FPRA")
Fieldfisher LLP
Fiona Campbell
FirstPort
George Newsom
Gerlinde Gniewosz
Gill Waystrade
Graham Paddock
Hazel Oliver
Heather Keates
Heulwen Egerton
HM Land Registry
Home Builders Federation
Howard Davies
Institute of Residential Property Management ("IRPM")
Irwin Mitchell LLP
J Brown
Jackie Roe
Jo Rostron
John Bunting PhD
John Byrne
John H Cooney
John Harvey
Julian Maples
Kamesh Venkataswamy
Kate Stephenson
Kathy Allen
Kevin Mullery
Kheya Bag
Laurence Target
Law Society
Leasehold Reform Group
Leila Allen
Letitia Crabb
Linden Limited
Liz Clayton and Carol Williams
Liz Justice
Lord Robert Walker
M D Sinclair
Malika Kassemi
Marathon House RTM Company Ltd
Mari Knowles
Martin Foulds
Martin Wood
Mary Dudley Seaver
McCarthy & Stone
Michael Bowen
Michael Harvey
Michael Kucharski
Mike Paley
Mrs K Melbye
Mrs Pat Meyrick
N A Carnie
National Leasehold Campaign
National Trust
Nicholas Warren
Nigel Shingler
Nikolas Andersen
Oliver Yun
Osborne Clarke LLP
Paul Clark
Paul Sams
Peter Bellenes
Peter Smith
Peter Williams
Philip Griffiths
Pinsent Masons LLP
Places for People
Professor James Driscoll
Quoin Commonhold Association
R M Campbell-Barr
Rawdon Crozier
Ray Harling
Raymond Hayes
Redrow Homes Ltd
Residents of Park House
Retirement Housing Group (“RHG”)
Rodney Townson
Roger Huxtable
Roger Jenking
Rosemary Herbert
Sandra Virgo
Shula Rich
Stan Marlow
Stephen Bedford
Stuart Ryan
Susan Ellis
Susan Stuckey
Suzanne McGreavy
The Berkeley Group Holding plc
The Property Ombudsman
Tony Martin
Trevor Leigh
Trowers & Hamlins LLP
UK Finance
Wrigleys Solicitors LLP
Yorkshire Building Society Group
Appendix 5: The limited liability of the freehold management company

5.1 The position under the 2002 Act compared with Freehold Management Companies by some or all of the leaseholders collectively. The FMC will then manage the building. The existence of FMCs will inevitably stand as a comparator to commonhold associations because of the FMC’s role in managing a block. The position of FMCs and Residents’ Management Companies (RMCs) generally has not been widely explored either in case law, or in legal writing, but we put forward the following points which would seem generally to be accepted as representing the law.

5.2 First, the FMC does appear to offer virtually unqualified limited liability to its members in that, if it is incorporated with limited liability, no one has suggested any basis upon which its members may be personally liable. It is possible for an FMC – like any other company – to make provision in its Articles of Association for its members to pay subscriptions to it, or to make other financial contributions to it. This principle was confirmed in the case of Morshead Mansions Ltd v Di Marco.

5.3 It is possible that the existence of a provision to require contributions from members might be used by a liquidator to demand sums from members in the event of insolvency (as described, in respect of commonhold associations, at paragraph 7.32 in Chapter 7), but there would seem to be no reported examples of this happening in the case of an FMC. Only if an FMC contained the provision in its original articles would all members be bound. If it was added to its articles subsequently, only those who had agreed to it

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1 We refer in this Annex to a “freehold management company”, on the basis that it owns the freehold to the building. We use the term “residents’ management company” (RMC) where a company which is owned by the leaseholders can manage the building, but does not own the freehold.

2 The existence of these was noted by L Crabb, “The Commonhold Association – As you like it” [1998] Conveyancer and Property Lawyer 283, but in her article “Commonhold Associations and their creditors” [2002] Insolvency Lawyer 204 she explicitly makes the comparison when considering the insolvency of the commonhold association. In a later article “The Commonhold and Leasehold Reform Act 2002: A company law perspective” [2004] Company Law 213, 215 to 216 she makes the point that members of what we are referring to as FMCs might also be subject to liability as members, though this seems unlikely for the reasons given at para 5.3 below.

3 The supposition underlies the 1998 Crabb article.

4 It has been brought to our attention that those who enter into a substantial contract with an FMC or RMC may require personal guarantees from the directors; but this does not detract from the main line of argument.

5 The company limited by guarantee is the preferred corporate vehicle for many professional associations and learned societies, whose Articles may well provide for the payment of an annual subscription.


would be liable. In any event, it seems that few FMCs include such a provision in their Articles.

5.4 In the ordinary course of events, therefore, if an FMC becomes insolvent, and a creditor petitions for its winding up, all the assets of the FMC would become available to the creditors generally. In practice this provision might not be as effective as it appears.

5.5 The only bank balances that would clearly come under the control of the liquidator would be any that are kept specifically for the income and expenditure of the company itself. Balances on these accounts are not likely to be significant. The balances relating to the service charges – both current balances and any in sinking or reserve funds - would be subject to a statutory trust for the leaseholders. Although they would come under the control of the liquidator, as trust funds they would not vest beneficially, and the leaseholders might well have grounds to apply for an independent trustee to be appointed. If a claim made against the FMC in the insolvency involved some contractual claim, relating perhaps to repair works, then the liquidator would arguably have recourse to the trust funds. If the claim against the FMC involved a ‘catastrophic’ tort claim, then it would appear that the trust funds would be entirely protected. But, overall, whether the service charge fund would be available to meet judgments and costs might well depend on the specific service charge provisions included in the lease and how broadly they were interpreted.

5.6 The main asset of the FMC might appear to be the freehold reversion of the development, but in practice its value will depend on variable factors.

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8 Companies Act 2006, s 25 requires on its face that an existing member expressly agree in writing to be bound by such a resolution, though arguably a member who had voted in favour of the resolution would be estopped from taking the point.

9 The Encyclopaedia of Forms and Precedents (Vol 25(4)(c)(2)C.70, rev 10/2015) contains a precedent for the Articles of Association of a nominee purchaser company under Pt I ch I of the LRHUDA 1993. No provision is made there for a subscription to be paid by members. The model articles for private companies limited by guarantee (Companies (Model Articles) Regulations 2008, SI 2008/3229, sch 2, as amended by the Mental Health (Discrimination) Act 2013) do not contain any such provision, though they would in any event need some modification if used for a nominee purchaser or other RMC/FMC. The model articles, as amended, may be accessed at https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies.

10 These would include: ground rents (so far as collected); fees for consents; fees to register assignments; fees for provision of information to prospective purchasers; all of which would be available to meet expenditure relating to the company itself eg company accountancy fees, and fees paid to Companies House.

11 Under the Landlord and Tenant Act 1987, s 42. The view of the ICAEW is that service charge balances should not appear on the balance sheet of an RMC, though service charge transactions should appear on the income and expenditure account.

12 This is the view taken by Lewin on Trusts (19th ed 2014), 22-019.

13 This might be the claim of the creditor which had petitioned for insolvency, or a claim by another creditor who was seeking to prove their debt in the insolvency.

14 On the basis that a claim relating to a judgment for damages and costs arising out of a building contract would be likely to be ‘costs incurred in connection with the matters for which the relevant service charge was payable’ (Landlord and Tenant Act 1987, s42(3)(a)).
There will be instances where the liquidator would be able to extract substantial value from the freehold reversion: for example, a liquidator might be able to sell off the attic or airspace over the roof to a developer. Selling garden land or leisure facilities might prove more difficult, as they would generally have to be sold subject to the rights granted under the leases. In many cases – perhaps most – it will not be possible for the liquidator to sell part of the freehold reversion.

The freehold reversion itself will sometimes be valuable particularly if there are short leases on one or more flats in respect of those leaseholders who did not participate in the collective purchase of the freehold and there are no headleases granted in favour of an investor in respect of those flats. But more often, when an FMC acquires the freehold, it will soon afterwards grant very long (999-year) leases at a nil or peppercorn rent to all participating leaseholders. Often there will be little real value remaining in the freehold reversion and even where there is value, it is fairly simple for leaseholders to remove any value in the freehold reversion by granting long leases of any valuable common part to special purpose vehicles.

5.7 If the freehold reversion were sold by the liquidator, then the leaseholders would be entitled to exercise the statutory right of first refusal and buy back the freehold. They would presumably set up a new FMC to acquire it.

5.8 If the freehold reversion were to be disclaimed by the liquidator as “onerous property”, then, again, the leaseholders could re-acquire the freehold from the Crown Estate.

5.9 What this means in practice is that, if leaseholders own their freehold through the medium of an FMC, and it becomes insolvent:

(1) they do not run any real risk of losing the equity in their homes, as they will retain the leases of their flats;

(2) if the liquidator of the FMC were able to sell the freehold, they would be able to reacquire it by exercising the right of first refusal;

(3) if the liquidator were unable to sell the freehold, they would be able to reacquire it from the Crown Estate;

(4) in either case, this would involve the cost of reacquisition, and the cost of setting up a new FMC, but there would be no question of having to meet the debts of the insolvent FMC; and

(5) the reserve funds of the former FMC would continue to be held on trust for the leaseholders: how far they were available to creditors would depend on the nature of their claims and the terms of the lease.

15 Under Pt I of the Landlord and Tenant Act 1987. This gives a “right of first refusal” to leaseholders. If their landlord wishes to sell the freehold of a block of flats, the leaseholders collectively are entitled to buy it by matching the price that has been offered by an outside investor.

16 Insolvency Act 1986, s 178 (see ch 7 n 52).
5.10 Views may differ on how far the FMC model strikes an appropriate balance between its leaseholder members, and the FMC’s creditors. Nevertheless, the current regime for enfranchised leasehold is a fact, and many leaseholders do indirectly own their freeholds as a result of it.

5.11 We take the view that commonhold will offer leaseholders several significant advantages, even if they already own their freehold through an FMC:

1. a freehold estate in their unit, with none of the “wasting asset” problems associated with leases, and no need to consider lease extensions;

2. the assurance that all their respective obligations to each other and to the association are set out in a single document, with no scope for inconsistency;

3. the ability to update and revise this document without trouble and expense;

4. a regime for consulting on and setting contributions to common expenses which is tailor-made for a self-governing association, with no need to comply with measures which are designed to protect leaseholders with “outside” landlords;\(^{17}\)

5. a structure which is designed to encourage co-operation and avoids the “landlord/leaseholder” dichotomy; and

6. the assurance that all costs relating to the running of the association itself (including accountancy and company fees) can be included in the commonhold contributions.

5.12 Our Call for Evidence suggests that it is rare for an FMC to become insolvent, although the possibility cannot be entirely disregarded. The position with commonhold associations is likely to be similar. It would be unfortunate therefore, if the apparent disadvantage of commonhold in delivering limited liability became a determinative factor when comparing it with the “leasehold with an FMC” or “enfranchised leasehold” model. But unless it is addressed, this may have two consequences.

1. If commonhold and enfranchised leasehold are offered as alternatives,\(^ {18}\) then some purchasers may be advised to avoid commonhold.

2. Converting to commonhold may well be most practicable for those leaseholders who already own their own freehold through the medium of an FMC, as they will have experience of running a company, and there would be no freeholder to buy out. In spite of the advantages of converting to commonhold, the possible loss of fully-limited liability would be for many a disincentive.

5.13 Whilst these are matters upon which we shall need to consider consultees’ views, our provisional stance is that, in order to be an attractive proposition, the commonhold

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\(^{17}\) Principally LTA 1985, ss 19 and 20.

\(^{18}\) It is of course possible that the use of commonhold could therefore be made compulsory. But if Government implements its intention to require that new leases of flats be granted at a nominal ground rent, there would be a more “even playing field” when comparing commonhold and “leasehold with a freehold management company”.

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association will need to offer unit owners a comparable degree of limited liability as is enjoyed by leaseholders who own their freehold via an FMC. This is, however, easier said than done, as the position of the FMC will vary, dependent upon a number of variable factors. The table set out below may assist those who wish to analyse in more detail the respective positions at present of the FMC, and the commonhold association if they are put into liquidation. Inevitably some of the views expressed there are somewhat speculative.

**TABLE COMPARING THE POSITION OF THE FMC AND THE COMMONHOLD ASSOCIATION ON INSOLVENCY**

<table>
<thead>
<tr>
<th>Freehold Management Company</th>
<th>Commonhold association</th>
</tr>
</thead>
<tbody>
<tr>
<td>The liquidator would probably be able to dispose of the attic space, or the air-space over it, if the structure of the building allows. Such a disposition would trigger the right of first refusal under Part I of the LTA 1987. In practice this might result in the existing members “buying it back” to avoid such a disposal. In effect, they would be making a contribution to the debts of the insolvent FMC.</td>
<td>The liquidator might be able to do the same here: it is unlikely that the unit owners could resist this, unless they came up with an equivalent sum of money. The construction of additional units would require an amendment to the CCS, but, if the commonhold association has realisable assets, such an amendment could arguably be imposed by the court as a condition under CLRA 2002, s 52(4)(d).</td>
</tr>
<tr>
<td>The liquidator would in theory be able to dispose of assets such as garden land which could be used for development, or leisure facilities such as a fitness suite, but if the leases grant the leaseholders rights to use them, in practice they may be unsaleable for any significant sum.</td>
<td>The liquidator would seem to have a better chance of ‘extracting value’ from the common parts of the commonhold, as it could be imposed by the court as a condition. The condition might also extend to the making of amendments to the CCS to remove unit owners’ rights to use these common parts.</td>
</tr>
<tr>
<td>Subject to the possibility of the value of such facilities being realised (as an additional element) the value of the freehold reversion will vary, depending on:</td>
<td>The CLRA 2002 has left the position of a successor association in a state of considerable uncertainty, as:</td>
</tr>
<tr>
<td>(1) the total ground rents reserved; and</td>
<td>(1) writers differ as to whether the appointment of a successor association should be the norm, without imposing conditions, or whether the court can exercise considerable discretion, including imposing a condition requiring</td>
</tr>
<tr>
<td>(2) the lengths of the terms unexpired on the leases.</td>
<td>further contributions.</td>
</tr>
</tbody>
</table>

---

19 Using a condition to ensure that the commonhold association disgorges valuable assets to meet a catastrophic claim might be seen as less objectionable than imposing a condition requiring further contributions.
<table>
<thead>
<tr>
<th>Freehold Management Company</th>
<th>Commonhold association</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generally, if the freehold is sold, it would be possible for the leaseholders collectively to re-acquire the freehold under Part I LTA 1987 at the price an outside investor would pay. If no investor were prepared to make an offer for the freehold reversion, a liquidator might disclaim the freehold, in which case the leaseholders collectively could re-acquire the freehold from the Crown Estate at the price that they would pay on an enfranchisement claim. The contribution required by the leaseholder towards the cost of re-acquisition would in practice be capped in accordance with the above.</td>
<td>the unit owners to make further contributions; the liquidator to continue to raise commonhold contributions, even if a successor association had been appointed; and, there does not appear to be anything specifically to exclude the possibility of the liquidator levying a further round of assessments against those owners who are solvent in an attempt to make up for contributions which cannot be recovered from unit owners who are bankrupt or against whom enforcement proceedings would clearly be a waste of money.</td>
</tr>
</tbody>
</table>

On the liquidation of a freehold management company:

(1) all the service charge accounts retain their protected trust status under section 42 of the Landlord and Tenant Act 1987. This includes both the current balances, and any reserve funds, whether or not they have, in compliance with the law, been lodged in a designated trust account;

(2) a creditor may have recourse to service charge funds if they represent: “costs incurred in connection with the matters for which the relevant service charges were payable”.

Tentatively we would suggest that the precise

On the liquidation of the commonhold:

(1) all the balances standing to the credit of the association become available for creditors;

(2) this includes ‘reserve funds’ which, until this point, had enjoyed a degree of protection from enforcement proceedings.

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20 See ch 7, para 7.18.
21 See ch 7, para 7.32.
22 See ch 7, para 7.33.
23 LTA 1987, s 42(3)(a).
24 CLRA s 39(4), s 56.
<table>
<thead>
<tr>
<th>Freehold Management Company</th>
<th>Commonhold association</th>
</tr>
</thead>
<tbody>
<tr>
<td>scope of this might depend on the wording of the service charge provisions in the leases. Typically, this might cover damages and costs payable as a result of a dispute with a building contractor, but not damages and costs payable as a result of a ‘catastrophic loss’ or of a neighbour dispute between the freehold management company and the owner of a neighbouring property.</td>
<td></td>
</tr>
<tr>
<td><strong>In addition</strong> to the above liabilities, those wishing to set up a new FMC would have to incur the legal and registration costs involved, and the legal costs of acquiring the freehold.</td>
<td>Those setting up a successor association would incur the legal and registration costs involved in setting one up; some additional legal costs might also be incurred in the liquidation.</td>
</tr>
</tbody>
</table>
Appendix 6: Proposals requiring terms to be added to, or amended in, the prescribed CCS

6.1 Throughout this Consultation Paper, we make provisional proposals which would require additional terms to be added (or existing terms to be amended) to the terms of the CCS prescribed by the Commonhold Regulations. For ease of reference, these are summarised in the table below.

<table>
<thead>
<tr>
<th>Proposal requiring terms to be added to, or amended in, the prescribed CCS</th>
<th>Paragraph reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>We provisionally propose that it should be possible to create “sections” within a commonhold. Provisions to give effect to this proposal may need to be added to the CCS.</td>
<td>5.55</td>
</tr>
<tr>
<td>We provisionally propose that a higher voting threshold for amending the CCS should be introduced.</td>
<td>8.68</td>
</tr>
<tr>
<td>We provisionally propose that the CCS should be amended so as to require that: (1) either a copy of the buildings policy and schedule, or sufficient details of it, should be supplied to all unit owners on or before they acquire a unit, and whenever the terms of the policy change; and (2) the commonhold association should confirm to unit owners and their mortgage lenders that the insurance is in existence on an annual basis, and when reasonably required at other times.</td>
<td>9.82</td>
</tr>
<tr>
<td>We provisionally propose that the CCS should expressly contain a power for the commonhold association to take out a directors’ and officers’ insurance policy.</td>
<td>9.95</td>
</tr>
<tr>
<td>We provisionally propose that the standard of repair stated in the CCS should be specifically extended to cover “renewals”, that is, the replacement of items which could not be economically repaired.</td>
<td>9.110(2)</td>
</tr>
<tr>
<td>We provisionally propose that the installation of insulation should be deemed to be a repair or renewal by the CCS.</td>
<td>9.110(3)</td>
</tr>
<tr>
<td>We provisionally propose that the CCS should be amended to provide that alterations to the common parts which are incidental to internal alterations made by a unit owner to his or her own unit should not require the consent of the members by an ordinary resolution.</td>
<td>9.141</td>
</tr>
<tr>
<td>Proposal requiring terms to be added to, or amended in, the prescribed CCS</td>
<td>Paragraph reference</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>We provisionally propose that the proposed contributions to shared costs, and to the reserve fund, should require the approval of the members of the commonhold association. Provisions to give effect to these proposals would need to be added to the CCS.</td>
<td>10.32 and 10.34</td>
</tr>
<tr>
<td>We invite consultees’ views as to the suggestion that if the proposed level of contributions failed to secure approval, the level of contributions required in the previous financial year should continue to apply. Provisions to give effect to this suggestion would need to be added to the CCS.</td>
<td>10.33</td>
</tr>
<tr>
<td>We provisionally propose that it should be possible for the CCS to include an index-linked “cap” on the amount of expenditure which could be incurred annually on the cost of “enhanced services”, as described in paragraph 10.27.</td>
<td>10.40(3)</td>
</tr>
<tr>
<td>We provisionally propose that, if a CCS contained such a “cap”, it could be removed only with the unanimous consent of the unit owners, or with the support of 80% of the available votes, and the approval of the Tribunal.</td>
<td>10.40(2)</td>
</tr>
<tr>
<td>We provisionally propose that the prescribed CCS should be amended to require all commonholds from the outset to have a reserve fund.</td>
<td>10.60</td>
</tr>
<tr>
<td>We provisionally propose that the directors or members should be able to set up reserve funds dedicated for specific purposes (“designated reserve funds”) as they might see fit. Provisions to give effect to this proposal may need to be added to the CCS.</td>
<td>10.62</td>
</tr>
<tr>
<td>We provisionally propose that it should be possible to change the designation of a designated reserve fund only by a resolution supported by 80% of the members, and with the approval of the Tribunal. Provisions to give effect to this proposal may need to be added to the CCS.</td>
<td>10.68</td>
</tr>
<tr>
<td>We provisionally propose that the CCS should be amended to make it possible to allocate to individual units within a commonhold different percentages that they must contribute towards different heads of cost.</td>
<td>10.94</td>
</tr>
<tr>
<td>We provisionally propose that, once a CUIC has been issued, an incoming unit owner should not be liable for further contributions which fall due, unless the commonhold association or its agent has notified the current owner’s conveyancers of the further liabilities. Provisions to give effect to this proposal may need to be added to the CCS.</td>
<td>10.117</td>
</tr>
<tr>
<td>Proposal requiring terms to be added to, or amended in, the prescribed CCS</td>
<td>Paragraph reference</td>
</tr>
<tr>
<td>-------------------------------------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>We provisionally propose that a charge over the common parts or a floating charge should only be able to be granted when either: (1) the unit owners unanimously consent to the charge: or (2) 80% of the unit owners consent to the charge, and approval is obtained from the First-tier Tribunal (Property Chamber) or the Residential Property Tribunal Wales. Provisions to give effect to this proposal may need to be added to the CCS.</td>
<td>11.37</td>
</tr>
<tr>
<td>We invite consultees’ views as to whether there should be a provision that, where a unit owner or tenant breaches the rules of the CCS, the unit owner, or tenant, should be required to indemnify the other unit owners and the commonhold association for any losses they reasonably incur as a result of the breach.</td>
<td>13.82</td>
</tr>
</tbody>
</table>
Appendix 7: Example prescribed forms for dispute resolution

<table>
<thead>
<tr>
<th>Request for action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before giving this notice the complainant must consider whether the problem might be resolved by direct negotiation or by the use of arbitration, mediation, conciliation, or any other form of dispute resolution procedure involving a third party, other than legal proceedings. Please refer to the commonhold community statement for further details and, if necessary, get independent advice.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name of commonhold</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name and address of commonhold association</th>
</tr>
</thead>
<tbody>
<tr>
<td>BANK:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name of complainant</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Address of complainant</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>I am the (tick and complete as appropriate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>□ unit-holder of unit number</td>
</tr>
<tr>
<td>□ tenant</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name of alleged defaulter</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Address of alleged defaulter</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Details of complaint (use additional sheet if necessary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I request that the commonhold association take action against the alleged defaulter.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>I have (tick as appropriate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>□ considered trying to resolve this problem by direct negotiation or by using arbitration, mediation, conciliation, or any other form of dispute resolution procedure involving a third party, other than legal proceedings, but I do not consider these methods to be appropriate</td>
</tr>
<tr>
<td>□ tried to resolve this problem by direct negotiation or by using arbitration, mediation, conciliation, or any other form of dispute resolution procedure involving a third party, other than legal proceedings, but without success</td>
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Reply to request for action

Please refer to the commonhold community statement for further details and, if necessary, get independent advice.

Name of commonhold

Name of complainant

Address of complainant

Name and address of commonhold association

Registered company number

The commonhold association acknowledges receipt of your request for action dated

DD/MM/YY

The commonhold association (tick as appropriate)

☐ requires further information before it is able to reach a conclusion on this matter

☐ accepts the validity of your complaint and will serve a default notice on the alleged defaulter

☐ will not serve a default notice on the alleged defaulter but allows you to enforce the right or duty against the alleged defaulter directly

☐ will not serve a complaints notice on the alleged defaulter and refuses you the right to take further action in relation to this matter

Further details (such as information required, action to be taken or reasons for not becoming involved in the dispute or reasons for not allowing the complaint to be taken any further

Is the association willing to try to resolve this problem by direct negotiation or by using arbitration, mediation, conciliation, or any other form of dispute resolution procedure involving a third party, other than legal proceedings?

☐ Yes

☐ No

Signed (on behalf of the commonhold association)

Date

Signed (please print)