



Commonhold

Consultation Paper



Lord Chancellor's Department

July 1996

Foreword

By The Lord Chancellor

The Right Honourable The Lord Mackay of Clashfern

I am very pleased to bring forward a draft Bill to show in detail how the Government intends to implement its proposals for Commonhold. This new kind of property ownership is designed to provide for England and Wales a system for the freehold ownership and communal management of flats and other interdependent properties.

By publishing the draft Bill now, I hope to give the maximum opportunity for people to consider and comment upon the Government's proposals before the introduction of a Bill in Parliament. The process of perfecting the detailed provisions will continue, and further contributions to this process will be most welcome.

Mackay of Clashfern

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1 Introduction

1.1 It is generally accepted that there is a deficiency in the structure of property law in England and Wales, compared with the vast majority of European, American and Commonwealth jurisdictions, in that it does not provide an adequate system for the ownership of freehold flats. At present, those who live in flats must rely on the leasehold system to ensure the upkeep of the buildings in which they live and the enforcement of rights and obligations as between neighbours. But the leasehold system has various drawbacks and may fail to serve those tenants whose property interest for practical purposes outweighs that of their landlords.

1.2 The draft Bill accompanying this consultation paper represents the Government's proposals for a new system of freehold property ownership (known as Commonhold) which will be of application to various kinds of properties which are managed collectively. The new system will not be limited to developments of residential flats, but will also be available for commercial or mixed-use developments including offices or business parks.

1.3 In addition to providing owners in multi-occupier developments with the means of owning the freehold in their premises, Commonhold will furnish them with a system for the efficient management of the development as a whole. As a result, Commonhold will have the dual advantages of

affording owners a measure of control and security which is often felt to be lacking in long leasehold developments, whilst avoiding the difficulties which attach to so-called "flying freehold" schemes.

1.4 This is the second consultation paper on Commonhold which has been published by the Lord Chancellor's Department. In November 1990 the Department published a document (Cm 1345) setting out a number of policy options in this regard, together with a Bill which was in early draft form. The proposals for reform which are contained in the new draft Bill follow consideration of the responses to the earlier consultation exercise and a re-working of the principles on which the old draft Bill was based in the light of subsequent developments in property law.

1.5 The new draft Commonhold Bill will be circulated to the widest possible audience, including Members of Parliament, lawyers and representatives of the property industry, as well as to members of the public and tenants' organisations.

1.6 Under the Deregulation Initiative, the costs and benefits of all proposals which may affect business, charities or voluntary organisations are assessed to ensure that any necessary regulation is proportionate to the problem it addresses. As Commonhold will be available for commercial or mixed-use developments as well as for purely residential blocks of flats, comments would also be welcome from those in business and the voluntary sector who might be involved with Commonhold on the way in which the scheme might impact on them. A Compliance Cost Assessment will accompany the Bill laid before Parliament should responses indicate that the scheme will impose new burdens.

1.7 The confidentiality of respondents will be respected if they so wish, but if no such request is made, it will be assumed that a response is not intended to be confidential.

1.8 Comments should be sent, as soon as possible, but by **27 September 1996 at the latest**, addressed to:

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Selborne House
54 - 60 Victoria Street
London SW1E 6QW
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2 Commonhold - An Overview

Nature of Commonhold Ownership

2.1 A commonhold is a freehold development divided into separately owned individual parts with arrangements for communal management and shared ownership of common parts through the medium of a "commonhold association". The individual flats or other properties which are comprised in a commonhold are referred to in the draft Bill as "units". A person who owns a unit will own the freehold estate in that unit. Consequently, there will be no other person (such as a landlord) who will have ownership rights superior to those of the unit owner. The right of a unit owner to retain his unit will be indefinite; unlike a leasehold interest, ownership of a commonhold unit will not be limited by reference to a particular period of time.

2.2 A unit owner will have certain statutory rights and obligations in relation to his fellow unit owners and the commonhold association (which will be responsible for the management of the commonhold as a whole). These rights and obligations are intended to ensure that the units are properly maintained and that they are not used in ways which would be detrimental to the rights of the occupiers of other units in the commonhold.

Tenancies of Commonhold Land

2.3 It will, of course, be possible for the owner of a commonhold unit to grant tenancies of that unit to other people. However, no tenancy can be granted for a period of more than 25 years and, when a commonhold is set up, any tenancy for a longer period will have its term reduced to 25 years. The purpose of Commonhold is to ensure that the person who has the greatest stake in a unit owns the freehold interest and has the rights and obligations which go with such ownership. By preventing long leases of land within a commonhold the Bill will ensure that units are not "sold" on long leases and that the problems of the existing leasehold system are not thereby carried forward into Commonhold.

Commonhold Associations

2.4 A commonhold will be managed by its commonhold association. The association will be established automatically when the commonhold is registered, and every unit owner will be a member of it, having rights to vote at meetings at which the association takes decisions on the management of the commonhold. In many cases a management committee will be set up in order to run the commonhold on a day to day basis without the need to involve all the unit owners in minor decisions.

2.5 The commonhold association will own the freehold of any common parts of the commonhold (such as hallways and stairs, lifts or communal garden areas). However, because each unit owner will own the freehold of his unit outright, the association will have no property interest in the units themselves.

2.6 Commonhold associations will have corporate status. This means that such associations will be able to do things (such as entering into contracts for the supply of goods or

services, or acquiring additional land for the common parts of the commonhold) in their own name, rather than through one or more of the unit owners. However, commonhold associations will not be registered companies and will not be subject to the detailed provisions of the Companies Acts. Instead, there will be streamlined provisions to govern the constitution, functions and operation of commonhold associations. As the purpose of commonhold associations will be limited to managing commonholds, they will not be able to carry on any trade or business.

Management & Finance

2.7 The commonhold association will be responsible for the upkeep of any common parts of the commonhold, and for the repair and maintenance of the fabric of the commonhold generally. The association will also be responsible for insuring the commonhold and for any rebuilding which may become necessary.

2.8 The costs which are incurred by a commonhold association in carrying out its functions will be borne by the unit owners in fixed proportions (which will have been agreed when the commonhold is established). The association will recover these costs from the unit owners by setting service charges. It will clearly be of great importance for commonhold associations to be able to collect the amounts due from each unit owner - both in order that the association has the funds it needs to continue operating, and to ensure that the majority of the unit owners do not end up paying for a recalcitrant minority. For these reasons, a commonhold association will have the power (in certain limited circumstances) to sell a unit over the head of the unit owner in order to recover arrears of service charge.

Bringing a Commonhold to an End

2.9 It will sometimes be necessary for a commonhold to be brought to an end and to wind up the affairs of the commonhold association. This may be the case, for example, if the buildings within the commonhold have been destroyed by fire or have otherwise reached the end of their useful lives, if all the units have been acquired by a single person who wishes to deal with the property in a different way, or if the association is unable to pay its debts. The draft Bill contains provisions enabling a commonhold to be brought to an end with the minimum of complexity, but with sufficient safeguards to protect the interests both of unit owners and of creditors.

Conversion to Commonhold

2.10 Commonhold is to be available for new developments (in which case the developer would establish the commonhold towards the end of the construction process, and would then sell off the individual units) or in respect of existing leasehold or freehold developments where those with an interest in them wish to convert to Commonhold. However, Commonhold will be an optional alternative to the existing systems of property ownership rather than a compulsory replacement, and the Government has no intention of abolishing the leasehold system.

2.11 As Commonhold is intended to be an essentially voluntary scheme, it will be necessary (subject to the exception referred to at paragraph 3.6 below) for all those who have a freehold or leasehold interest in the property (or a charge over such an interest) to consent to a conversion. Whilst Commonhold was at one time associated with proposals for leasehold enfranchisement, which were subsequently enacted as part of the Leasehold Reform,

Housing and Urban Development Act 1993, the two concepts are quite distinct. In bringing forward proposals for Commonhold it is not intended to extend the rights of tenants compulsorily to acquire the freeholds of their buildings.

Draft Bill

2.12 The new draft Bill is divided into four Parts, and comprises fifty six clauses and twelve Schedules. The following three sections of this paper give a brief commentary on the principal provisions of the draft Bill, and outline the way in which those provisions achieve the features of Commonhold mentioned above.

3 Draft Bill

- Parts I & II

3.1 The two clauses in Part I of the Bill outline the main features of Commonhold and make it clear that, whilst the Bill makes provision for a new kind of freehold ownership, Commonhold is not a new estate in land. A person owning a unit in a commonhold will hold a freehold estate in that unit (but this will have special attributes which do not apply to other freehold land).

3.2 Part II of the Bill comprises clauses 3 - 27 (together with the first six Schedules). These are the principal provisions of the Bill and set out the requirements for setting up a commonhold, for its continued operation thereafter and for the management of the affairs of its commonhold association.

Setting Up a Commonhold

3.3 A commonhold will be established by the registration of a "commonhold declaration" at the Land Registry. The declaration will define the land within the commonhold and will also define the extent of the individual units. In addition, the commonhold declaration will set out other information which will be needed for the operation of the commonhold, such as the voting rights which will attach to each unit, the proportions in which unit owners will be obliged to contribute to the commonhold association's running costs and the

relative capital values of the units. (Clauses 4 - 7).

The Rôle of the Promoter

3.4 The person who applies for the registration of the commonhold declaration is to be known as the promoter (clause 9). If a commonhold is established in relation to a newly built development, the promoter is likely to be the developer. It will also be possible for owners in existing developments to convert to Commonhold (for example, where leaseholders collectively have obtained the freehold in their development under the Leasehold Reform, Housing and Urban Development Act 1993). However, as the promoter will be required to be the registered proprietor of the freehold estate in the whole of the proposed commonhold land, it is likely that a nominee of the owners will act as the promoter in such cases, and that arrangements will be made for the nominee to transfer the units to the relevant owners once the registration has been completed.

Requirements for Registration

3.5 Before registering a commonhold declaration, the Land Registry will check that it contains the necessary details regarding such matters as voting rights and service charge fractions. The Land Registry must also be satisfied as to a number of matters (in addition to any questions relating to the promoter's title to the land), including the fact that each building on the land has reached the required stage of construction, that the land is not subject to any agricultural tenancies, that any amendments in the declaration to the standard regulations governing the operation of commonholds are in a form that is permitted, and that the requirements as to obtaining the consents of interested parties have been complied with. (Clause 9).

Consents to Registration

3.6 As already indicated, it will only be possible to convert an existing development into a commonhold if those who

own the freehold and any leasehold interests in the property (and their mortgagees) agree. (Clause 10). However, the Bill does recognise that it may sometimes be difficult to achieve unanimous agreement to a conversion, and it is intended that regulations will be made supplementing clauses 10 and 11 to provide that the court may dispense with the consent of the tenants of up to 20% of the prospective units if it considers it reasonable to do so and on such terms (as to compensation for example) as it thinks fit. However, the court will not be able to dispense with the consent of a person who has a tenancy of 21 years or more, or a business tenancy. The consent of the freeholder will also be required in every case.

Functions of the Commonhold Association

3.7 Once a commonhold has been set up, it will be the duty of the commonhold association to manage the commonhold and, in particular, to manage any common parts, to enforce the obligations of the unit owners, to take out insurance cover in respect of the commonhold as a whole (and to carry out any necessary repairs or reinstatement) and to look after the financial affairs of the association. (Clause 20 & Schedule 5).

3.8 Since commonhold associations will not be able to carry on any trade or business, they will not be subject to the same degree of regulation as companies and will not be registered at the Companies Registry or be obliged to submit annual returns and file accounts. They will, however, be obliged to prepare accounts for their members, and the Land Registry will be responsible for registering and overseeing the use of commonhold association names. (Clauses 15 and 16 & Schedules 2 and 3).

Service Charges

3.9 The commonhold association will set service charges in order to recover from the unit owners the costs which it

incurs in carrying out its functions. From time to time unit owners may also be called upon to contribute to one or more reserve funds which the association is required to maintain for the protection of unit owners and creditors against large items of expenditure; in connection with the replacement of a roof or lift, for example. (Clauses 21 - 24 & Schedule 6).

3.10 The proportion of any service charge which will be payable by the owner of a particular unit is that which is stated to be the unit's service charge fraction in the commonhold declaration.

3.11 If a unit owner fails to pay his due proportion of any service charge set by the commonhold association, the association will be able to require that any tenant of the unit should make the payments due under the tenancy to the association rather than to the unit owner. However, the association's ultimate remedy for non-payment of service charge contributions will be the power to sell the unit (free of the interest of the unit owner and any mortgagee) and to recover the arrears from the proceeds of sale. Clearly, a commonhold association will not be entitled to exercise its power of sale until it has given adequate notice of its intention to do so and, having recovered the arrears from the proceeds of sale, it will be obliged to account for the balance to the former unit owner, or (as is perhaps more likely) to his mortgagee. (Schedule 6, paragraphs 4 - 12).

4 Draft Bill - Part III

4.1 Part III of the Bill which comprises clauses 28 - 41 (together with Schedules 7 - 11) makes provision for what is to happen in the event of a commonhold association getting into financial difficulties or if, for whatever reason, the unit owners wish to bring the commonhold to an end. It is anticipated that these provisions will not be of frequent application in practice.

Unlimited Liability of Commonhold Association

4.2 As the commonhold association will have corporate status and will be responsible for the management of the commonhold, it will enter into any necessary contracts (such as contracts with builders or suppliers, for example) in its own name, and liability for debts incurred in this way will rest with the association. The association's liability to its creditors will be unlimited, but individual unit owners will have no direct personal liability to the association's creditors.

Restricted Liability of Unit Owners

4.3 Ultimately, of course, it will be the unit owners who must meet the liabilities of the commonhold association and, during the lifetime of the commonhold, this will be achieved via the service charge mechanism. In the event of the commonhold being wound up, however, the outstanding liabilities of the association will fall to be met by the former unit owners in accordance with the principle of "restricted liability" which will ensure that each former unit

owner is not required to contribute more than his due proportion of the association's liabilities. It will be necessary to apply the principle of restricted liability on the winding up of a commonhold because it would clearly be wrong for those assets of the association which represent the interest of one former unit owner to be used to discharge debts which should be paid by another. The principle is embodied in clause 38 and Schedule 10, which contains provisions intended to ensure its fair application even in cases where some unit owners have arrears of service charges outstanding at the commencement of the winding up.

Commonhold Administration Orders

4.4 A creditor of a commonhold association which fails to pay its debts will not be able to appoint a receiver or to take enforcement action against the association's assets (clause 27). However, he will be able to apply to the court for a commonhold administration order, which will appoint a commonhold administrator to take over the management of the commonhold in order to secure that its affairs are put on a sound basis (or in order to safeguard the interests of creditors and members of the association as a preliminary to a winding up). (Clauses 29 - 31 & Schedule 11, Part I).

4.5 Any member of a commonhold association and any mortgagee of a unit or the Secretary of State will also be able to apply for a commonhold administration order on the ground that the association's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members or their mortgagees. (Clause 30).

Winding Up a Commonhold

4.6 A commonhold may be wound up voluntarily if all the unit owners (and their mortgagees) agree and the procedures laid down by Part I of Schedule 8 to the Bill are complied with. A commonhold may also be wound up

voluntarily if some of the members of the association do not agree, but the winding up resolution is approved by the court.

4.7 A commonhold may be wound up by the court on the application of a commonhold administrator if the court is satisfied that the commonhold association is irretrievably insolvent. The court may also make a winding up order where, on the application of the Secretary of State (who will have powers to investigate the affairs of commonhold associations), it is satisfied that it is in the public interest that the commonhold should be wound up. (Clause 32 & Schedule 8, Part II).

4.8 The effect of the commencement of a winding up will be to vest the units in the liquidator who will realise the assets of the association and meet its liabilities in accordance with the principle of restricted liability. The former owners will be permitted to continue to live (or trade) in the units until the liquidator has decided how best to realise the assets and, depending on the liabilities of the association and the resources of a particular former unit owner, it may be possible for his former property to be transferred back to him at the end of the winding up process. The original commonhold, however, will cease to exist. (Clauses 33 - 41).

4.9 Any tenancies to which a unit is subject immediately before a winding up will continue after the commencement, with the substitution of the commonhold association as landlord in place of the former unit owner. However, such tenancies may be brought to an end if possession is required for purposes of redevelopment in connection with the winding up (as well as on any other ground normally available to a landlord). (Clause 37 & Schedule 9).

5 Draft Bill

- Part IV

5.1 Part IV of the Bill comprises clauses 42 - 56 (together with Schedule 12) and deals with a number of miscellaneous matters of general application to the operation of commonholds, and with changes to the existing law which will be necessary as a consequence of the implementation of the Commonhold system.

5.2 So, for example, the Bill makes provision for the protection of minority interests (clause 43), for the phased establishment of a large development as a commonhold (clause 44), and for the protection of third parties dealing with commonhold associations (clause 48). The Bill also provides (in Schedule 12) for the rights of tenants of public sector landlords and registered social landlords (as introduced by the Housing Act 1996) in the context of a commonhold development, and for the application of the law of compulsory purchase to land within a commonhold.

