



**Law  
Commission**  
Reforming the law

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# **Reinvigorating commonhold: the alternative to leasehold ownership**

## **Summary**

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**Law Com No 394 (Summary)**  
**21 July 2020**

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# REINVIGORATING COMMONHOLD: THE ALTERNATIVE TO LEASEHOLD OWNERSHIP

## PART I: INTRODUCTION

1.1 On 21 July 2020, we published three reports, together with supporting documents.

- (1) Leasehold home ownership: buying your freehold or extending your lease;
- (2) Leasehold home ownership: exercising the right to manage; and
- (3) Reinvigorating commonhold: the alternative to leasehold ownership.

The reports contain a large number of recommendations that would significantly improve the position of homeowners in England and Wales. Our full reports are available at [www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/](http://www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/).

1.2 We have produced detailed summary documents for each report, of which this is one. Those summary documents are aimed primarily at those who have an existing knowledge of the regimes covered by our reports. However, we have also produced shorter summary documents that cover our three projects in one document and which are designed to be accessible to all. Those shorter summaries are also available from [www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/](http://www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/). Our report on the commonhold regime is called the "Report" in this summary.

1.3 Our homes are hugely important, and housing policy is high up the political agenda. There is a growing political consensus that leasehold ownership is an unsatisfactory way of owning residential property. Commonhold offers an alternative.

1.4 Commonhold was introduced in 2004<sup>1</sup> as a way of enabling the freehold ownership of flats which avoids the shortcomings of leasehold ownership. It is similar to structures used across the world. However, fewer than 20 commonhold developments have been established in England and Wales since the commonhold legislation came into force. Unlike practices in other countries across the world, flats continue to be owned, almost universally, on a leasehold basis. Flat owners in England and Wales continue to hold leasehold interests that will expire at some point in the future, and live in buildings where the landlord makes the key decisions about management and costs. Commonhold enables flats to be owned on a freehold basis so that owners' interests can last forever, and transfers decision making power to the homeowners.

1.5 Our commonhold project seeks to identify why commonhold has failed to take off, despite its benefits, and to address problems with the law of commonhold which have been preventing its uptake.

1.6 Our commonhold project was included in our Thirteenth Programme of Law Reform.<sup>2</sup> As highlighted above, the project forms part of a wider project on residential leasehold and commonhold reform. The Terms of Reference for our commonhold project require us to "reinvigorate commonhold as a workable alternative to leasehold, for both

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<sup>1</sup> By the Commonhold and Leasehold Reform Act 2002.

<sup>2</sup> Thirteenth Programme of Law Reform (2017) Law Com No 377.

existing and new homes". Our full Terms of Reference are set out at Appendix 1 to the Report.

- 1.7 We consulted on wide-ranging proposals to reform the commonhold regime between December 2018 and March 2019. We held consultation events in England and Wales and attended several events and meetings hosted by other organisations. We received 524 responses to the Consultation Paper.<sup>3</sup>
- 1.8 When making our recommendations set out in the Report, we have carefully considered all consultees' comments and the reasons why they favoured or opposed a provisional proposal, and weighed the arguments made.
- 1.9 We make 121 recommendations in the Report. These recommendations aim to make commonhold not just a *workable* alternative to residential leasehold ownership, but the *preferred* alternative.
- 1.10 Alongside our three Reports, we have published a number of supporting documents. Those documents include a combined summary of our three residential leasehold and commonhold law reform projects, the responses to the Consultation Paper (which have been redacted to remove personal information and to protect those who provided their responses in confidence), a statistical summary of how consultees responded to the consultation questions, and an open letter to lenders on taking commonhold units as security.
- 1.11 This Summary provides an overview of our main recommendations in each chapter of the Report, with cross-references to the paragraphs in the Report which set out the relevant recommendations. It does not capture all the recommendations in the Report, but instead focuses on areas in which we are recommending a key change to the current law. It is designed to help readers find their way through the Report and identify areas that may be of interest to them.

### **Overview of the commonhold structure and its benefits**

- 1.12 Before moving on to a summary of the main recommendations contained in the Report, we set out a brief overview of the commonhold structure and some of its key benefits.
- 1.13 Commonhold provides a structure to manage the relationship between separate, individually owned properties. The freehold of each property in a commonhold, referred to as a "unit" (such as a flat), is owned by a commonhold "unit owner". While commonhold was primarily designed to facilitate the freehold ownership of flats, freehold houses can also be commonhold units, as can non-residential premises.
- 1.14 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. This company is called the "commonhold association". Unit owners, as members of the commonhold association, can vote on decisions which affect the commonhold.

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<sup>3</sup> Reinvigorating commonhold: the alternative to leasehold ownership (2018) Law Commission Consultation Paper No 241.

- 1.15 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. The directors can also appoint an agent to manage the commonhold, which we anticipate will be the case in most commonholds.
- 1.16 Each commonhold has a “commonhold community statement” (“CCS”). This is the commonhold’s rulebook which sets out the rights and obligations of the unit owners and the commonhold association.
- 1.17 Additionally, each commonhold must adopt “articles of association” which govern how the commonhold association operates and how management decisions about the commonhold can be made (such as how directors can be appointed).
- 1.18 Commonhold has a number of benefits.
- (1) *Freehold ownership.* Commonhold allows people to own their properties forever.
  - (2) *No landlord.* Commonhold gives ownership and control of the building to the owners.
  - (3) *No requirement to pay ground rent.*
  - (4) *No forfeiture.*<sup>4</sup>
  - (5) *Standardisation.* Each commonhold’s CCS and articles of association must contain terms which are prescribed by law. These terms help to create a consistency across all commonholds and simplify conveyancing.
  - (6) *Flexibility to accommodate change.* There is flexibility to update the prescribed rules of all commonholds by regulations, and for unit owners to add and amend rules which are specific to a particular commonhold (“local rules”) to accommodate changing needs.
  - (7) *Simplified management.* There is one document (the CCS) which sets out the rights and obligations of all the unit owners in the commonhold.
  - (8) *Bespoke legislation.* The commonhold legislation has been specifically designed for the collective ownership of interdependent properties without an external landlord.

## **PART II: CONVERSION TO COMMONHOLD**

- 1.19 Conversion to commonhold is the process by which existing leaseholders can join together to convert their building (or buildings) to commonhold and replace their existing leasehold interests with the commonhold structure.

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<sup>4</sup> In leasehold, if 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.

- 1.20 The overall aim of our project is to “reinvigorate commonhold as a workable alternative to leasehold, for both existing and new homes”. Commonhold therefore needs to be available both to prospective homebuyers and existing leaseholders. At present, conversion is almost impossible to achieve as it requires the unanimous agreement of nearly every interested party in the building. That includes the freeholder, all leaseholders and every lender with a mortgage secured over the properties. Commonhold may therefore currently be out of reach for the vast majority of leaseholders.
- 1.21 Part II of the Report is dedicated to making commonhold accessible to leaseholders. Our recommendations will make it much easier for leaseholders to convert to commonhold, and ensure that a workable management structure is in place once leaseholders have converted. There are five chapters in Part II of the Report which address the following questions.

### **Chapter 3: What is conversion to commonhold?**

- 1.22 In Chapter 3, we explain what happens when a building converts from leasehold to commonhold. On conversion, each individual flat in the building becomes a “commonhold unit”. Leaseholders who participate in the conversion will obtain the freehold of their flats and become commonhold unit owners, in exchange for their leasehold interests. The freehold of the common parts of the building will be owned by a commonhold association, of which the unit owners will be members: paragraphs 3.7 to 3.14.
- 1.23 We also discuss how conversion compares with “buying a share of the freehold” through a collective freehold acquisition (“CFA”) claim.<sup>5</sup> This is the collective right of leaseholders to acquire the freehold of their building without the freeholder’s consent and is considered in our separate enfranchisement report.<sup>6</sup> Only by converting to commonhold can leaseholders obtain the freehold of their flats, remove the landlord and tenant relationship and benefit from legislation that has been specifically designed for the collective ownership of buildings: paragraphs 3.42 to 3.53.

### **Chapter 4: When should conversion be possible?**

- 1.24 In Chapter 4 we revisit the current law’s requirement of unanimity for conversion. Our recommendations will ensure that leaseholders are able to convert without needing to obtain the agreement of every person in the building, while still ensuring the interests of those who have not agreed are protected. Under our recommendations leaseholders will be able to convert:
- (1) without the freeholder’s consent. We recommend that, where the freeholder does not agree to the conversion, leaseholders should acquire the freehold compulsorily through a CFA claim as part of the process of converting: paragraph 4.39. To avoid the delays and costs which might otherwise be created by following two distinct processes of acquiring the freehold

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<sup>5</sup> This right is currently referred to as collective enfranchisement. In our separate enfranchisement report, we refer to it as the right as “collective freehold acquisition” and we adopt this new terminology in the Commonhold Report.

<sup>6</sup> Leasehold home ownership: buying your freehold or extending your lease (2020) Law Com 392.

compulsorily and converting, leaseholders will be able to follow a single streamlined “acquire and convert” procedure, discussed further below;

- (2) without the unanimous agreement of leaseholders. Consultees said that it is unrealistic to expect all leaseholders to consent to the conversion, especially in larger blocks, where many leaseholders may be absent from the property. To make conversion a viable option for leaseholders, we recommend that the requirement for unanimity should be removed and replaced with a lower threshold: paragraph 4.51.

A number of consultees suggested adopting a threshold of 50% leaseholder support, to ensure that a majority of leaseholders in the building support the decision. 50% is also the same threshold of leaseholder support as is required for leaseholders to bring a CFA claim. We agree with this suggestion, and recommend that conversion to commonhold should be possible where at least half of the leaseholders in the building support the conversion: paragraph 4.90. We are persuaded by arguments that it is can already be difficult for leaseholders to obtain the 50% support necessary to bring a CFA claim. If the threshold of leaseholder support were any higher, conversion to commonhold would likely be prevented in many leasehold blocks. Making the threshold support as low as possible was supported by many leaseholders who responded to our consultation; and

- (3) without the consent of mortgage lenders. To facilitate conversion without the consent of mortgage lenders we recommend that Government works with lenders to ensure that lenders will accept the automatic transfer of their mortgages from the leasehold title to the commonhold title on conversion: paragraph 4.116. We make this recommendation on the basis that commonhold will offer lenders improved security compared to that available over leasehold interests. In exchange for security over a time-limited leasehold interest, the lender would receive security over a permanent freehold interest, which is not susceptible to forfeiture.

## **Chapter 5: How will conversion Options 1 and 2 operate?**

1.25 In Chapter 5 we make recommendations to ensure that the optimal management structure is in place after a conversion has taken place. We consulted on two alternative conversion schemes in our Consultation Paper. The differences between these two schemes relate to the interest that leaseholders, who have not agreed to the conversion (“non-consenting leaseholders”), will receive at the point of conversion, but each option has wider implications for others in the building. We make a number of recommendations about how each option would work in practice if adopted by Government.

- (1) Option 1: Following conversion, non-consenting leaseholders would continue to own the leasehold of their flat. However, as this arrangement complicates the operation of the commonhold, and fails to take full advantage of the benefits of commonhold over leasehold, these leases should not be able to continue indefinitely. We therefore make a number of recommendations to “phase out” leasehold interests, and ensure that, at some point in the future, all remaining leases are upgraded to a commonhold unit: paragraphs 5.6 to 5.49.

- (2) Option 2: Following conversion, non-consenting leaseholders would be required to take the title to their commonhold unit at the point of conversion, in exchange for their leasehold interest. All owners would therefore hold the same type of interest on conversion, which would simplify the management of the building.
- 1.26 On taking a commonhold unit, either at the point of conversion (Option 2) or at some point in the future (Option 1), the non-consenting leaseholders would be required to comply with the terms of the CCS. The CCS would have been prepared by the leaseholders participating in the conversion, and so non-consenting leaseholders would not have had a say on its terms. Our revised scheme ensures that the terms of the CCS have not been prepared in such a way as to prejudice the interests of the non-consenting leaseholders: paragraphs 5.171 to 5.200.<sup>7</sup> By doing so, our regime ensures that the interests of non-consenting leaseholders are sufficiently protected in the CCS, without providing them with grounds to block or delay the conversion process.

## Chapter 6: Which is our preferred conversion option?

- 1.27 In Chapter 6 we recommend that Government should take forward conversion Option 2: paragraph 6.57. This means that, at the point of conversion, all leaseholders would take a commonhold unit and become members of the commonhold association. Many consultees responding to the Consultation Paper called for more radical steps towards the replacement of leasehold with commonhold ownership than would be achieved under Option 1. Option 2 would enable the commonhold structure to work as intended and would allow existing leaseholders to benefit immediately from the same advantages as will be present in new commonhold developments. The management of the building would be simplified as all owners will have the same type of interest (a commonhold unit), and all owners would be governed by the terms of the building's CCS and by commonhold legislation.
- 1.28 Option 2 raises some practical issues, particularly with regards to the financing of conversion. On conversion, non-consenting leaseholders' property interests would be upgraded from leasehold to freehold. They would no longer have an asset which reduces in value as the lease term runs down and no ground rent would be payable. While the freeholder must be compensated for their freehold interest, it would be unfair and impractical at the point of conversion to expect non-consenting leaseholders to contribute towards this cost, and pay for their upgraded freehold interest. These leaseholders did not choose (and might not be able to afford) that upgrade. Participating leaseholders will therefore need to find a way to finance non-consenting leaseholders' shares of acquiring the freehold (with or without the help of external investment). In order to prevent non-consenting leaseholders from benefitting from a windfall, we provisionally proposed in the Consultation Paper that non-consenting leaseholders should have a charge placed over their commonhold units in favour of those who financed the freehold purchase. This charge would ensure that, on the subsequent sale of their commonhold units, the non-consenting

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<sup>7</sup> Under our recommendations, the participating leaseholders may require the freeholder to take the commonhold units of some of the flats on conversion to commonhold, in order to reduce the cost of acquiring the freehold as part of the CFA claim: paragraphs 5.95 and 5.156. Where leaseholders make this election, the regime of safeguards discussed here will extend to the former freeholder.

leaseholders would be required to repay those who had financed their share of the freehold purchase.

- 1.29 While a sizeable majority of consultees agreed with this provisional proposal, several consultees highlighted that our suggested approach could in fact have unforeseen negative implications for non-consenting leaseholders. Some consultees also doubted that investors would want to take a charge.
- 1.30 As a result of these concerns we recommend that, in adopting Option 2, Government should provide equity loans to non-consenting leaseholders to cover their share of financing the freehold: paragraph 6.57. These loans could operate in a similar way to shared equity loans under Government's and the Welsh Government's Help to Buy schemes.<sup>8</sup> Non-consenting leaseholders should take their commonhold unit subject to a charge in favour of the Government, which ranks after any existing mortgage, and which would be repayable on the sale of the unit. In order to provide the correct incentive structure, we suggest that Help to Buy loans should also be offered to participating leaseholders on an optional basis, so that participating leaseholders can elect whether or not to benefit from such financing and take a unit subject to a charge.
- 1.31 If such assistance from Government is not possible, we recommend that Option 1 should be adopted, which will offer a more gradual route to commonhold's full advantages: paragraph 6.58.

## **Chapter 7: What is the procedure for converting?**

- 1.32 In the final chapter of this Part, Chapter 7, we consider the practical steps involved in converting to commonhold. We recommend a number of reforms that will make it simpler and more cost-effective for leaseholders to convert: paragraphs 7.84 to 7.91. In particular, we reduce the number of forms that leaseholders will need to complete and submit to HM Land Registry. And we make recommendations to prevent conversion claims being frustrated by those opposed to the conversion and by leaseholders withdrawing consent. These reforms will provide leaseholders with greater clarity and confidence in the process of converting to commonhold. Further, our recommendations provide leaseholders with greater control over the conversion process. Currently it is only possible for the freeholder to apply to register the commonhold at HM Land Registry. We recommend that the leaseholders (in addition to the freeholder) should be able to register the commonhold at HM Land Registry once the terms of the freehold acquisition have been agreed.
- 1.33 Where leaseholders need to acquire the freehold compulsorily as part of the conversion process, they will be able to take advantage of our recommended acquire and convert procedure: paragraph 7.17. This process has been specifically designed to provide the quickest and most effective way of acquiring the freehold and

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<sup>8</sup> Under such existing schemes, prospective homeowners are able to obtain loans representing a percentage of the value of the property (typically of up to 20%) in order to buy the property. The Government secures its financing by way of a charge over the property, which ranks after any existing mortgages. If the borrower decided to sell the property, he or she would need to repay Government the percentage of the value of the property, as at the date of sale. The Government scheme does not require the borrower to make up any shortfall if the property drops in value. See Homes England, Help to Buy Buyers' Guide (2018), at <https://www.helptobuy.gov.uk/wp-content/uploads/Help-to-Buy-Buyers-Guide-Feb-2018-FINAL.pdf>.

converting to commonhold. It incorporates all the steps necessary to acquire the freehold and to put in place the commonhold management structure.

### **PART III: NEW COMMONHOLD DEVELOPMENTS**

1.34 Part III of the Report considers how developers can use commonhold to create complex modern-day developments. The current commonhold legislation has been criticised for being “one size fits all” and unsuited to more complicated mixed-use developments. Our recommendations in this Part will provide developers with the flexibility they need to use commonhold for all developments, irrespective of the development’s size, make-up or complexity.

#### **Chapter 8: Mixed-use and multi-block developments**

1.35 In Chapter 8, we recommend a new tool – “sections” – that will enable developers to separate out the management of different types of interest within a commonhold, such as commercial and residential interests: paragraph 8.30. The existing commonhold legislation does not reflect the reality that different owners in a commonhold will have different types of interest. Every unit owner can currently vote on all decisions of the commonhold association, regardless of the extent to which they are affected by a particular decision. And every owner is required to contribute towards all the commonhold’s costs, regardless of the extent to which they benefit from that cost. Sections can be used to ensure that only owners within a particular section are able to vote on matters affecting that section, and that only those who benefit from a particular service are responsible for paying for it.<sup>9</sup>

1.36 We make a number of recommendations concerning the way in which sections should operate.

- (1) To ensure that sections are only created where there is good reason and to maintain a degree of standardisation across all commonholds, we recommend certain criteria that should have to be satisfied before sections can be created: paragraph 8.72. These criteria focus on the nature of the unit (for instance, whether the unit is residential or commercial, or whether the units to form the section are in a separate block) rather than the identity of the owner, which is more transient.
- (2) In addition to the developer, who may establish sections at the outset, we recommend that unit owners should be able to vote to create and combine sections at a later date, after having experienced living in the commonhold: paragraph 8.39. As creating and combining sections may result in an alteration of owners’ financing obligations and voting rights, we recommend that a high voting threshold should have to be met, and that unit owners affected by the decision should have a right to apply to the First-tier Tribunal (Property

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<sup>9</sup> In addition to sections, there are a number of other tools that will be at developers’ disposal under the current law and our recommendations elsewhere in the Report. Developers will be able to designate certain areas of the commonhold as “limited use areas”, which can only be accessed/used by one or more unit owners. Additionally, we recommend in Chapter 13 that the developer should be able to set up separate “heads of cost”, rather than each unit owner paying the same allocated percentage towards every cost within the commonhold: paragraph 13.58.

Chamber) in England or the Leasehold Valuation Tribunal in Wales (“the Tribunal”) under our minority protection regime:<sup>10</sup> paragraph 8.86.

- (3) We also recommend that it should be possible for “section committees” to be established to represent the interests of unit owners within a particular section: paragraph 8.99. Directors of the commonhold will be able to delegate powers to section committees in order to give unit owners within a section greater control over the day-to-day management of their section.

## Chapter 9: Development rights

- 1.37 “Development rights” are the mechanism by which a developer will be able to complete the development of a commonhold scheme after some, but not all, of the commonhold units have been sold. On the sale of the first unit within a registered commonhold scheme, the commonhold association will become the owner of all the common parts within that scheme. The commonhold legislation gives the developer the ability to reserve development rights in the CCS over the commonhold, in order to allow changes to the commonhold once ownership has been transferred to the association and the unit owners. At present, the developer can only select rights from an exhaustive list set out in the legislation. Consultees told us that this list is too constraining compared to the freedom developers have in leasehold developments. At the same time, there are few safeguards within the current regime to protect those who buy commonhold units before the development is complete.
- 1.38 In Chapter 9, we recommend a revised regime for the creation of new commonhold developments, which carefully balances the need to provide sufficient flexibility for developers with enhanced safeguards and certainty for purchasers. We recommend that there should no longer be an exhaustive list of development rights, but that developers should be free to reserve in the CCS the rights that are best suited to the size and needs of their particular development: paragraph 9.34. However, we recommend that developers should only be permitted to exercise these rights for a purpose connected with the completion of the development, or the marketing of the units: paragraph 9.39.<sup>11</sup> The rights should not be available, for example, to make changes which are for the sole purpose of making the units more attractive to new purchasers at the expense of the existing owners. Unit owners who consider that a development right has been exercised in breach of the permitted purpose will be able to challenge the exercise of this right in the Tribunal: paragraph 9.58. We recommend that guidance should be produced which will provide examples of when an exercise of development right will or will not be in line with the permitted purpose: paragraph 9.38.
- 1.39 To complement this new regime of development rights, we explain how developers will be able to build up commonhold developments in phases in order to retain maximum control and flexibility over the ongoing development: paragraphs 9.13 to 9.15. The current law envisages that the whole development must be registered as commonhold at the outset. We suggest that the developer should opt to register the commonhold in phases, once building within a particular phase is (or is almost)

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<sup>10</sup> Our minority protection regime is set out in Chapter 17.

<sup>11</sup> Additionally, we recommend maintaining the existing restriction on the exercise of development rights that the developer must not exercise rights in a way which would interfere unreasonably with unit owners’ enjoyment of their units of their ability to exercise rights granted in the CCS: paragraphs 9.41 to 9.54.

complete. Following the sale of a unit in a phase, the commonhold association will only become the owner of common parts within that completed phase. The developer will remain the owner of the rest of the site and free to continue working on the development as they wish. We provide a worked example at paragraph 9.99 which demonstrates the benefits of registering in phases, and how our revised scheme of development rights is intended to operate.

## **PART IV: THE COMMONHOLD COMMUNITY**

- 1.40 In Part IV we consider the commonhold community statement and look at which leaseholders should be permitted to form part of the commonhold community. Our recommendations ensure that the CCS provides owners with clarity and certainty as to their rights and obligations, while retaining sufficient flexibility to meet their needs. Our recommendations in this Part will also ensure that there are affordable ways to access commonhold ownership, and to finance ownership in a way that is compliant with religious beliefs.

### **Chapter 10: The commonhold community statement**

- 1.41 The CCS is a key feature of every commonhold. In leasehold blocks, owners' rights and obligations are set out in the terms of individual leases. In commonholds, there will be one document, the CCS, which sets out the rights and obligations of all owners in the building and the commonhold association. Each CCS must adopt a layout which is prescribed by regulations and must contain prescribed terms. This ensures a degree of consistency across commonholds, simplifies conveyancing and aids consumer understanding of their rights and obligations. There is also scope to add rules at various points throughout the CCS which are tailored to the particular commonhold. These are a commonhold's "local rules".
- 1.42 In Chapter 10, we make recommendations to ensure that the CCS is transparent and easy to use. Currently, the CCS contains a mix of the local rules which are specific to the particular commonhold, and rules which are prescribed by legislation and will be the same in every commonhold. This makes it hard for unit owners to identify which rules are unique to their commonhold. We recommend that the CCS should only contain the local rules: paragraph 10.136. The prescribed rules should be provided as a separate document. Purchasers will therefore be able to see, at a glance, the distinctive features of their commonhold. This recommendation will also reduce the cost and administration involved if the prescribed rules are subsequently updated. It would remove the need for the directors of the association to update and re-register the CCS at HM Land Registry every time the regulations are changed.
- 1.43 Additionally, to make the CCS more accessible to unit owners in larger, more complex developments, we recommend that it should be possible to collate rules which are specific to a particular section in schedules to the CCS: paragraph 10.143. Unit owners would therefore only have to read the rules which were applicable to the commonhold as a whole, and the rules specific to their own section.
- 1.44 There are few restrictions on the content of local rules. Local rules must not, for example, contravene the prescribed terms of the CCS and cannot restrict a unit

owners' ability to create, transfer or grant interests in his or her unit.<sup>12</sup> This latter restriction generates ambiguity. We recommend that the effect of the restriction should be as follows.

- (1) The restriction should not prevent unit owners from banning lettings of up to six months in the local rules of their commonhold, apart from in the social housing sector: paragraph 10.44. Unit owners can therefore take control of the decision whether or not to permit short term lets (which, we have been told can be a source of nuisance) without unduly impacting the private rental and social housing sectors.
- (2) The restriction should, however, prevent the inclusion of event fees in the CCS (apart from in specialist retirement housing): paragraph 10.61. In the vast majority of commonholds, event fees will not serve a useful purpose and provide scope for abuse that should not be introduced in the commonhold model.

1.45 Our recommendations will make it harder to amend the local rules of the CCS in order to protect the expectations of those who buy commonhold units. Currently most local rules can be added or amended to the CCS with the support of a simple majority of those turning up to vote. Local rules can cover a wide variety of issues, including how unit owners are able to use their properties. Changing these rules therefore has the potential to have a significant impact on unit owners' experience of living in a commonhold. We recommend that changes to the local rules should only be possible where 75% of those turning up to vote support the decision: paragraph 10.91. Increasing the threshold in this way will ensure that changes to the commonhold rules will not be made lightly, but that there remains flexibility for the commonhold rules to evolve according to changing needs. As an additional protection, we recommend that where a change is made which particularly affects one of the unit owners, that owner will have the right to apply to the Tribunal under our minority protection regime (set out in Chapter 17): paragraph 10.99.

## **Chapter 11: Permissible residential leases in commonhold**

1.46 Commonhold unit owners are currently prohibited from granting residential leases of their units for a period longer than seven years. As commonhold was designed to overcome the shortcomings of residential leasehold ownership, it was considered inappropriate to allow long residential leases to continue to be created. However, the strict ban on residential leases gives rise to certain undesirable consequences. It prevents some arrangements that would otherwise enable purchasers to access commonhold on an affordable basis.

1.47 In particular, the ban would prevent shared ownership leases being granted within commonhold. Shared ownership plays a key role in government's programme for the provision of affordable homes.<sup>13</sup> At present, grant funding for the provision of shared

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<sup>12</sup> Additionally, a local rule cannot provide for the loss of a unit owner's interest on the occurrence or non-occurrence of a specified event: paragraph 10.13.

<sup>13</sup> Shared ownership enables a purchaser to buy an initial share in the property and to buy additional shares incrementally until he or she obtains full ownership. See glossary.

ownership is only available in respect of shared ownership *leases* (rather than any other model of shared ownership<sup>14</sup>). In Chapter 11 we recommend that it should be possible for shared ownership leases to be granted within commonhold, as a limited exception to the general prohibition on residential leases of more than seven years: paragraph 11.19. In order to be able to rely on the exception, it will be necessary for shared ownership leases to contain the fundamental clauses prescribed by Homes England and the Welsh Government. These clauses provide protections for leaseholders, such as standardised rent provisions, which should avoid abuses which have been witnessed in the leasehold sector being carried over into commonhold.

- 1.48 We make a further exception in this chapter to permit lease-based home purchase plans, which are regulated by the Financial Conduct Authority (“FCA”): paragraph 11.145. This exception will enable commonhold ownership to be financed in a way which avoids the grant of a mortgage, and the payment of interest, which is necessary to comply with some religious beliefs. FCA regulation will add a layer of protection for anyone using those arrangements.
- 1.49 Accommodating these two arrangements in commonholds is important in ensuring that as many people as possible are able to buy in a commonhold development. We make a number of recommendations throughout this chapter to integrate these two categories of permissible leases successfully into the commonhold model. These recommendations will mitigate the complexity that might otherwise arise from having a mix of leasehold and commonhold interests within the same building. Our recommendations ensure that, so far as possible, leaseholders who use these schemes will gain the same advantages and protections of living in a commonhold that are enjoyed by unit owners.

## **PART V: MANAGING AND FINANCING THE COMMONHOLD**

- 1.50 In Part V of the Report, we look more closely at the operation of the commonhold. We make recommendations to ensure that the commonhold is well managed and that day-to-day repairs are carried out efficiently. We provide a robust regime for financing these works, and give unit owners greater say in how the costs of running their commonhold are met. We recommend that every commonhold must maintain a reserve fund towards future repairs, which will allow the cost of major works to be budgeted for. We also provide unit owners with easier ways of raising finance to undertake essential works in the event that emergencies arise.

### **Chapter 12: Management and maintenance**

- 1.51 In Chapter 12 we look at ways to simplify the procedures involved in running the commonhold, and the obligations of the commonhold association to keep the fabric of the building in repair.
- 1.52 The directors of the commonhold association play a vital role. They are responsible for running the commonhold and make many key decisions. Unit owners may act as directors themselves, or they may appoint professional directors. The directors may

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<sup>14</sup> In the Commonhold Consultation Paper we explained that it may be possible, in time, to move to an alternative model of shared ownership that does not depend upon a lease, such as a co-ownership trust. CP, para 12.24 to 12.26.

also decide to delegate the day-to-day running of the commonhold to a professional managing agent. Indeed, we anticipate that this will be the norm in most commonholds.

- 1.53 We recommend that directors of a commonhold association should be elected on an annual basis by an ordinary resolution (that is, by more than 50% of the vote), and, when necessary, appointed by the existing directors: paragraph 12.10. Our recommended procedure is simpler and more democratic than the current law.
- 1.54 It is particularly important that a commonhold association has directors in post to avoid the association being struck off at Companies' House. Striking-off would dissolve the commonhold structure, and the units would become "flying freeholds". Obligations between unit owners would not be enforceable, leading to a lacuna in the building's maintenance. We therefore recommend that, if unit owners are unwilling to serve as directors of the commonhold association, it should be possible for a unit owner, a mortgage lender and other affected party to apply to the Tribunal for professional directors to be appointed: paragraph 12.32.
- 1.55 We also make recommendations to ensure that directors are accountable, and can be removed if they are failing in their duties. Where directors have been persistently breaching their duties in the CCS, we recommend that it should be possible for unit owners, mortgage lenders and other affected parties to apply to the Tribunal for the temporary appointment of a replacement director: paragraph 12.64. This offers a more direct and effective remedy than is available under the current law.
- 1.56 It is essential that commonholds are properly insured so that, if the commonhold is damaged or destroyed, there will be sufficient funds available to pay for its reinstatement without threatening the solvency of the commonhold association. It is unclear under the current law whether commonhold associations can take out a single policy to cover the whole of the commonhold building. Our recommendations address this problem, ensuring that commonholds are able to procure valid buildings insurance: paragraph 12.117. Given the importance of proper insurance, we recommend that unit owners should have a right to see a copy of the buildings policy on demand: paragraph 12.126.
- 1.57 Commonhold associations are at risk from claims brought by members of the public who have accidents within the commonhold. We recommend that all commonholds should be required to take out and maintain public liability insurance to preserve their solvency: paragraph 12.143. We also confirm that commonhold associations should have the power to take out directors' and officers' insurance: paragraph 12.152. Such a provision ought to encourage unit owners, who might otherwise be dissuaded, to apply to become directors.
- 1.58 We recommend reforms to clarify the repairing obligations of the commonhold association. The current law requires the association to keep the common parts in adequate repair. Our recommendations clarify that this duty extends to replacement when repair is not possible or economical: paragraph 12.174. We also recommend that it should be possible for commonholds to impose a higher standard of repair in the local rules of the CCS: paragraph 12.160.

- 1.59 To protect unit owners from damage resulting from the actions (or inactions) of their neighbours, we recommend that unit owners should not allow their unit to fall into such a state as to affect the enjoyment of another unit or common parts: paragraphs 12.194 and 12.207. We also make it easier for unit owners to approve minor alterations to their properties which affect the common parts. Currently, any alterations to the common parts need to be approved by an ordinary resolution of unit owners. We recommend that unit owners should instead be able to delegate the authority for approving minor alterations to the commonhold's directors: paragraph 12.227.
- 1.60 Finally, in this chapter, we make recommendations concerning long-term contracts. When a commonhold is set up, the developer may enter into long-term contracts for the repair of particular facilities, such as a lift, or for the provision of services, such as cleaning. Experience of similar situations in leasehold developments suggests that unit owners may take the view that they have been bound into an unfair bargain. We recommend that unit owners should have a time-limited right to cancel long-term contracts after taking control of the commonhold from the developer, subject to a procedure by which the contract can be approved in advance by the Tribunal: paragraph 12.225.

### **Chapter 13: Contributions to shared costs**

- 1.61 Commonholds must raise money to maintain and insure their building or buildings, and to provide services to unit owners. We refer to the sums that unit owners are required to pay towards the day-to-day running of the commonhold as "contributions to shared costs". This contribution is separate to the contribution to the reserve fund, discussed in Chapter 14.<sup>15</sup>
- 1.62 In Chapter 13, we make recommendations to provide unit owners with greater control over the commonhold's costs, to ensure that costs are allocated proportionately between owners and to enhance commonhold associations' powers to recover outstanding contributions when a unit is sold.
- 1.63 A widespread complaint of leasehold home ownership is the lack of control leaseholders have over the expenditure for which they are liable. Landlords control the service charge costs which leaseholders are required to pay. Under the current commonhold legislation, commonhold directors must consult with unit owners when setting the cost budget, but they do not have to act on unit owners' objections. We recommend instead that unit owners should vote to approve the directors' proposed annual budget, giving the unit owners a substantially greater degree of control over the commonhold's expenditure: paragraph 13.29. Unlike leasehold, unit owners will not simply have a right to challenge expenditure – they will decide whether it should be incurred at all.
- 1.64 As the same individuals both control and pay for the commonhold's costs, commonhold provides inherent protection to keep expenditure at a reasonable level. However, we make recommendations to strengthen the protection against excessive expenditure. We recommend that it should be possible for commonholds to set a threshold on the amount that may be spent on certain costs without challenge:

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<sup>15</sup> The contribution to shared costs and contribution to the reserve fund are referred to collectively in the Report as "commonhold contributions": see glossary.

paragraph 13.135. A majority of unit holders may approve expenditure in excess of that threshold, but if they do, any unit owner may refer the matter to the Tribunal to determine whether the excess expenditure should be allowed (in accordance with our minority protection regime, see Chapter 17 below).

- 1.65 Under the current law, each unit owner's share of the costs of the commonhold must be paid towards all of the commonhold's expenditure. That is the case regardless of the extent to which the owner benefits from the cost being incurred. To provide greater flexibility, and to protect unit owners from being required to pay a disproportionate contribution, we recommend that it should be possible to create different pools or "heads of cost": paragraph 13.58. This would allow only those who have access to, or benefit from, particular services or rights to contribute to that particular head of cost. For example, if only some unit owners have access to parking, heads of cost could be used so that only those unit owners were required to contribute towards the upkeep of the car park.
- 1.66 We also recommend that all unit owners should have a right to challenge their share of expenditure on the basis that the allocation is not reasonably proportionate: paragraph 13.102. Currently, unit owners only have a right to challenge an amendment to the cost allocation on the basis that the amendment would allocate a "significantly disproportionate" percentage to the unit. Our recommendation will allow unit holders to challenge allocations that were disproportionate from the outset, or which had become disproportionate through a change in circumstances. This significantly enhances the protection currently available in commonhold, and provides greater protection to challenge allocations of costs than is possible in leasehold.
- 1.67 Finally, we make recommendations to retain and refine the process by which a commonhold association may recover contributions to the shared costs which are in arrears when an owner sells his or her unit: paragraphs 13.157 to 13.223. Our recommendations better enable the recovery of these costs from either the previous unit owner or an incoming purchaser in order to protect the solvency of the commonhold association.

## **Chapter 14: Reserve funds**

- 1.68 A reserve fund is a pool of money which is set aside to cover future costs – usually essential one-off major works, such as the replacement of a lift or the roof. By paying a contribution to the reserve fund, unit owners can spread the costs of major works over a number of years which will reduce the risk of unit owners being unable to meet large and unexpected bills.
- 1.69 Currently, commonhold associations are permitted, but not required, to establish reserve funds. Given the importance of maintaining adequate reserves, we recommend that it should be compulsory for all commonhold associations to have a reserve fund: paragraph 14.11. This will help ensure that commonholds plan for future expenditure, protecting the association's solvency and enabling vital works to be carried out promptly and effectively.
- 1.70 Our recommendations also aim to provide greater flexibility in the management of reserve funds. Commonholds should be able to tailor the use of reserve funds to suit their circumstances. Under the current law, it is unclear whether commonholds only

have power to set up “general” reserve funds (that is, funds that can be used for any type of expenditure) or whether it is possible to establish funds which are designated for particular purposes (such as the future repair of a lift or roof). We recommend that it should be possible for commonholds to use both types of reserve fund, so that commonholds are free to establish the funds appropriate for their make-up and facilities: paragraphs 14.43 and 14.50.

- 1.71 We recommend that commonholds should, subject to safeguards, be able to re-designate funds so that a commonhold can meet urgent expenditure unrelated to the purpose of a designated fund: paragraph 14.84. We also recommend that commonholds should be able to “borrow” from a designated fund for an unrelated purpose: paragraph 14.95. These recommendations are intended to give commonhold associations flexibility to find pragmatic solutions. Associations will be able to protect their solvency, and avoid having to borrow or demand emergency contributions from its owners at short notice.
- 1.72 Leasehold reserve funds are protected from the claims of creditors. This privileged status reflects the importance of reserves, and the need to preserve them. We recommend that commonhold reserve funds should enjoy similar protection: paragraph 14.70. They should be held on statutory trust so that the funds are only available where a creditor’s claim relates to the purpose of the fund.

## **Chapter 15: Responding to emergencies**

- 1.73 The need to remove cladding following the Grenfell Tower fire tragedy has demonstrated that emergency works can be difficult to foresee and involve crippling expense. In the event of an emergency, a commonhold may suddenly face a call for expenditure which neither its reserve funds nor the resources of its unit owners are able to cover.
- 1.74 Chapter 15 sets out recommendations aimed at making commonholds as resilient as possible. They would put commonhold unit owners in a better position than leaseholders to deal promptly and effectively with emergencies. While some landlords and developers have responded to the need to replace cladding following the Grenfell Tower tragedy by effecting remedial works or by supporting leaseholders to fund emergency works, many have not. As a matter of law, the responsibility to pay generally lies with leaseholders, and ultimately Government has stepped in to provide funding. The commonhold system is able to give owners more control over how to respond to the requirement to raise finance unexpectedly.
- 1.75 The chapter clarifies three ways in which commonhold unit owners may raise emergency finance. First, the association may sell off any of the commonhold’s common parts that can be carved out and independently sold. For example, the commonhold might include garden areas which have development potential, or facilities such as a fitness suite or swimming pool that could be sold. It is also possible that the roof and airspace over a building might have realisable development value.
- 1.76 The second and third mechanisms for raising emergency finance involve borrowing. The association may be able to borrow more easily, and at a lower rate of interest, if it is able to offer the lender security for its loan. The association already has the ability to borrow funds, and, in return grant a fixed charge over the common parts. We

recommend that the law makes clear that it is also possible to grant a fixed charge over part (rather than all) the common parts: paragraph 15.55. A fixed charge over *part* of the common parts is more likely to be attractive to the association and to the lender because it provides a greater degree of certainty as to the land at stake.

- 1.77 Where the association does not have sufficient assets over which it can offer a fixed charge, the association could offer lenders a “floating charge” over the commonhold’s future income stream. We recommend that the law explicitly authorises commonhold associations to create floating charges, in the same way as it already refers to fixed charges.
- 1.78 Each of these three options has, or has the potential to have, a significant impact on the unit owners and their lenders. All three options could affect the value of the units, a concern to unit owners and their mortgage lenders alike. Consequently, these methods of “emergency finance” are intended only as a last resort where other resources – emergency demands for contributions, reliance on insurance and recourse to reserve funds – are not available. Given their impact, we also make a number of recommendations to ensure that the interests of the unit owners and their mortgage lenders are protected. In particular, we recommend that in all cases where mortgages are secured on the units, the Tribunal must approve the decision to grant the charge or to sell the common parts: paragraphs 15.56 and 15.87.

## **PART VI: DISPUTE RESOLUTION, MINORITY PROTECTION AND ENFORCEMENT**

- 1.79 Commonhold, by its nature, brings together numerous individuals whose properties and interests are interconnected. It is important that as and when disagreements arise, they can be resolved effectively. In Part VI of the Report, we make recommendations to improve commonhold’s bespoke process for resolving disputes, to introduce a new regime of “minority protection” for unit owners who are outvoted on important decisions, and to provide the association with enhanced powers to tackle financial breaches of the CCS.

### **Chapter 16: Dispute resolution**

- 1.80 Commonhold has its own bespoke procedure for resolving disputes that arise within the commonhold. This procedure is set out in the CCS and must be followed before taking legal action, except in an emergency or where the dispute relates to a duty to pay money (in which case the procedure is optional).
- 1.81 In Chapter 16, we set out recommendations to make the commonhold dispute resolution procedure more effective, so that disagreements can be resolved quickly and cheaply, avoiding court action wherever possible. We also make recommendations to “future proof” the procedure, should Government take forward plans for a New Homes Ombudsman and a combined Housing Court.
- 1.82 At present, some parts of the dispute resolution process are unnecessarily long-winded and could delay the point at which an owner obtains redress. Currently, the association may step into disputes between unit owners, preventing one owner from taking direct action against another. The unit owner would then be required to follow another procedure to challenge the decision of the association before being able to take the action they want. To avoid unwarranted cost and delay, we

recommend that the association should only be able to provide its opinion on the alleged breach to assist the owner in judging whether it is prudent to proceed with their case, but should not be able to prevent action from proceeding: paragraph 16.15. The association is not a judicial body and is not best placed to decide on a dispute between owners.

- 1.83 We also address technicalities in the commonhold dispute resolution procedure. There are a number of prescribed forms that unit owners must complete when following the procedure, causing concern that a failure to use the correct form, or mistakes on the form, could prevent a claim from progressing. We recommend that there should be an expectation that prescribed forms are used as an aid in resolving the dispute, but that a failure to use the forms should not prevent a claim from proceeding: paragraph 16.23. Similarly, we recommend that a court or Tribunal should have discretion to disregard non-compliance with the procedure, or order the parties to take any appropriate alternative steps, according to the particular circumstances of the case: paragraph 16.29.
- 1.84 We recommend that unit owners who have breached the CCS should indemnify those who have incurred costs in taking action against them: paragraph 16.94. This recommendation will ensure that the association and the unit owners are not left out of pocket following breaches of the CCS, and will deter non-compliance.
- 1.85 The current law requires a commonhold association to be a member of an approved ombudsman scheme and for certain disputes to be referred to this scheme as part of the dispute resolution process. In fact, however, no ombudsman scheme has yet been approved. We recommend that referral to an ombudsman scheme should be an optional, rather than a mandatory, part of our revised dispute resolution process: paragraph 16.45. Owners should consider referral to an ombudsman alongside other forms of alternative dispute resolution (“ADR”). The dispute resolution process needs to be flexible enough to cover a wide range of commonholds and mandatory membership of a scheme could place too great a financial burden on smaller commonholds. Ombudsman schemes are used elsewhere to address a perceived power imbalance between the complainant and the respondent business or company. The same imbalance does not arise in commonhold: the commonhold association is made up of the unit owners themselves, who will be in control of the commonhold’s decisions.
- 1.86 We make recommendations to reinforce the role of ADR within the commonhold dispute resolution procedure. At the moment, parties are merely required to “consider” ADR with no guidance over how they might approach ADR nor signposting towards organisations that might be able to provide impartial assistance. We recommend that the CCS be updated to require parties not only to “consider” forms of ADR, but also to engage with ADR if appropriate and proportionate: paragraph 16.64. The CCS should also provide more information about what forms of ADR are available, and why ADR is important. In the future, the CCS can be updated to accommodate new forms of ADR, for example, if a New Homes Ombudsman is established by Government, as is planned. There are also plans to introduce a new Housing Complaints Resolution Service which could perform a useful role in mediating commonhold disputes. Further, in our Report, we suggest that when commonhold has become more widespread, Government should consider introducing a commonhold specific regulator to oversee

the operation of commonholds: paragraph 16.100. The creation of these bodies ought to encourage the use of ADR within commonhold disputes and, if they are introduced, we recommend that engagement with these bodies should be a condition of bringing a subsequent court or Tribunal claim: paragraph 16.64.

- 1.87 Finally, we recommend that, (unless and until a combined Housing Court is established) jurisdiction for resolving commonhold disputes should be transferred from the court to the Tribunal: paragraph 16.73.<sup>16</sup> The benefits of transferring disputes to the Tribunal include the relatively informal nature of proceedings, the reduced emphasis on legal representation (which should result in lower costs) and the likelihood that the Tribunal's expertise in deciding leasehold disputes will be relevant to commonhold. If proposals for a new Housing Court are taken forward (which, would combine the functions of the county court and Tribunal), we recommend that the dispute resolution process should be moved from the CCS into a bespoke pre-action protocol: paragraph 16.80.<sup>17</sup> Moving the dispute resolution process to a pre-action protocol would avoid the risk of commonhold disputes falling within the scope of one or more other court protocols, which have not been designed with commonhold in mind.

## **Chapter 17: Minority interests within commonhold**

- 1.88 Collective decision-making is one of the main advantages of commonhold. It allows unit owners to have a direct say in the management of their commonhold, contrasting with the position in most leasehold blocks. A consequence of this system is that there is a risk that a majority of unit owners will make decisions that impact upon the interests of the minority who have not agreed to the decision.
- 1.89 In Chapter 17, we make recommendations that will strike a better balance between majority rule and protection for the minority. We recommend that, in certain defined circumstances, unit owners who are affected by a decision of the commonhold association should be able to challenge that decision at the Tribunal, by invoking our new regime of minority protection: paragraph 17.28.
- 1.90 Not all decisions of the commonhold will be susceptible to challenge under our recommended minority protection regime. The Tribunal should not be the forum for all commonhold decisions; that would risk disproportionate disruption and expense, and would undermine the democratic nature of commonhold. We recommend that there should be four "gateways" to minority protection: paragraph 17.28. These are areas that have the greatest potential impact on unit owners where the owner would otherwise be left without a remedy. Unit owners will be able to challenge a decision to:
- (1) vary the terms of the CCS;
  - (2) create a section (or sections);

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<sup>16</sup> Except where the Tribunal does not have the power to make an order (for example to grant an injunction) in which case the court will retain jurisdiction. If the Tribunal transfers all or part of the dispute to the court, we recommend that the court should be able to exercise all the jurisdiction that the Tribunal could have exercised: paragraph 16.73(2)).

<sup>17</sup> Pre-action protocols set out steps which should be followed before starting certain types of court proceedings, but are not used in Tribunal proceedings.

- (3) combine two or more sections; and
  - (4) approve a budget in excess of a cost threshold set in the CCS.
- 1.91 Other significant decisions within the commonhold already have built-in protections for those opposed to the decision, for example a decision to terminate the commonhold voluntarily (see Chapter 20 below).
- 1.92 When deciding whether to grant a remedy to a unit owner under the minority protection regime, we recommend that the Tribunal should take into account a number of statutory factors: paragraph 17.61. The factors include, whether the applicant had turned up to vote in the decision complained of (and if so, how they voted), the degree of impact on the applicant, and the reasons behind the association's decision. We recommend that the Tribunal should also be able to consider any other factors deemed relevant in the particular case, so that the Tribunal has sufficient flexibility to address all cases coming before it.
- 1.93 We also recommend that the Tribunal should have flexibility when deciding what remedy to award: paragraphs 17.75 and 17.76. The Tribunal should be able to annul the decision complained of, allow the decision to stand, or allow the decision to stand but only subject to certain conditions. For example, the Tribunal might allow the condition to stand subject to the commonhold association paying compensation to the applicant. As another example, the Tribunal might specify that the decision should only apply for the future or should not apply to the applicant (either at all or for a specified period of time). By giving the Tribunal the ability to impose conditions, the Tribunal will be empowered to promote effective compromises between the applicant and the commonhold association.

## **Chapter 18: Enforcement**

- 1.94 In Chapter 18, we explain how important it is that unit owners pay their commonhold contributions on time. Funds will need to be available to pay for the maintenance of the common parts and for the provision of any services to the unit owners. Where unit owners fail to pay their share of the commonhold contributions on time, there is a risk that the other unit owners will be required to make up the shortfall until the sums can be recovered. If the other unit owners are unable to meet this shortfall, and the commonhold's costs go unpaid, the association's creditors might decide to bring insolvency proceedings against the association. Whilst in Chapter 19 we recommend measures to protect unit owners and their mortgage lenders in the event of the association's insolvency, it would be far preferable to avoid insolvency in the first place.
- 1.95 Despite the importance of ensuring that commonhold contributions are received, the association has limited powers under the current law to recover sums from those who fail to pay their share. We recommend a new power for the commonhold association to apply to court for the sale of a defaulting owner's unit in order to recover the arrears: paragraph 18.131. This new right will put the association in a much stronger position to preserve the solvency of the association and protect the other owners in the building. The right is, however, subject to safeguards, and the sale of the defaulting owner's unit should be a last resort. We have modelled the new power on a

similar power recommended by the Law Commission in its report, Termination of Tenancies for Tenant Default.<sup>18</sup>

1.96 The key features of the association's new power are as follows.

- (1) We recommend that the commonhold association should follow a specific pre-action protocol before applying to court for an order for sale: paragraph 18.133. The association should provide the unit owner with reasonable opportunities to clear the arrears and avoid further action. The protocol will emphasise that an application to court should only be made where all other reasonable avenues have been exhausted.
- (2) To provide certainty to unit owners and to protect them from undue pressure, we recommend that the association should only be able to seek a court order where the arrears have reached £1,000, or any amount has been outstanding for over a year: paragraph 18.134. However, irrespective of the level of arrears, the court should only order the sale where reasonable and proportionate to do so in all the circumstances.
- (3) If the court decides to order the sale of the unit, a receiver will normally be appointed to distribute the proceeds of sale: paragraph 18.137.<sup>19</sup> We recommend that, after the receivers' fees have been paid, the association should be repaid the arrears, followed by the repayment of any secured creditors (such as mortgage lenders). Any balance would then be returned to the owner: paragraph 18.138.
- (4) To protect any lender with an interest secured over the commonhold unit, we recommend that the association should notify the lender within a reasonable period that arrears have reached the £1,000 threshold or have been outstanding for a year: paragraph 18.135. The association must provide the lender with 28 days in which to take steps to protect its interest, before applying to court. If the association fails to do so, the court may stay the proceedings in order to provide the lender with an opportunity to protect its interest.

## **PART VII: INSOLVENCY AND TERMINATION**

1.97 In the final Part of our Report, we consider the end of a commonhold association's life. The association might be brought to an end involuntarily because of the association's insolvency, or voluntarily, by a vote of the unit owners.

### **Chapter 19: Protecting the commonhold from insolvency and striking-off**

1.98 The commonhold association plays a pivotal role in the commonhold management structure. The association owns and manages the common parts of the commonhold; it is the forum within which unit owners take decisions; and is the body that represents

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<sup>18</sup> In this separate report, the Law Commission recommends abolishing leasehold forfeiture and replacing it with a more proportionate regime addressing lease breaches. See Termination of Tenancies for Tenant Default (2006) Law Com No 303.

<sup>19</sup> We also recommend that, in order to take control of the costs involved, the lender should be able to request to take over the conduct of the sale of the unit in place of the receiver. If the lender's application is successful, it must distribute the proceeds of sale in accordance with the court's order: paragraph 18.137.

unit owners collectively in their dealings with the outside world. If the association were wound up or struck off, there would be no body to own or manage the common parts or represent the owners' interests. Unit owners would be left with "flying freeholds", without an effective structure to manage the relationship between their interconnected properties. In those circumstances unit owners would also lose the rights that had been granted to them in the CCS over the common parts. It is therefore essential that there are measures in place to ensure that the association is preserved. This is the subject of Chapter 19.

- 1.99 Commonhold associations are companies limited by guarantee, and so need to comply with the same requirements under company law as any other company, such as filing annual returns. Failure to comply with these requirements can lead to a company being struck off. Given the significant consequences of striking-off for a commonhold association, we consider that additional protections are required. We recommend that Companies House consider writing to the personal addresses of the directors of a commonhold association, as well as to the commonhold association's registered office, to notify them if the association is at risk of being struck off: paragraph 19.12. That will provide the directors with greater opportunity to respond to the risk and take the necessary action.
- 1.100 One of our key policy objectives in this project has been to protect the commonhold association's solvency wherever possible. Throughout the Report, we recommend a range of reforms supporting that aim: for example, our recommended requirement for the association to maintain a reserve fund (discussed in Chapter 14). While this makes the insolvency of a commonhold association less likely, it does not make it impossible. To incentivise the uptake of commonhold, our reforms seek to ensure that unit owners in a commonhold are no worse off on the insolvency of a commonhold association than leaseholders in a leaseholder-controlled block would be on the insolvency of a freehold management company.
- 1.101 We have therefore considered how far it is possible to protect unit owners from the impact of their commonhold association becoming insolvent. In Chapter 19 we recommend measures to protect the limited liability of the unit owners towards the association's debts and to allow the association to be reinstated more easily through the appointment of a "successor association".
- 1.102 Under the current law it is unclear whether a liquidator could demand contributions from unit owners in order to clear the debts of an insolvent commonhold association. This could undermine the unit owners' limited liability and would put owners in a less favourable position than owners in a leaseholder controlled block, who are unlikely to be subject to further demands.<sup>20</sup> We therefore recommend that a liquidator appointed to wind up an insolvent commonhold association should not be able to demand further commonhold contributions from unit owners in order to reduce the indebtedness of the association: paragraph 19.69. We do, however, recommend that liquidators should have power to sell off any saleable common parts of the commonhold to reduce the

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<sup>20</sup> It would only be possible for a liquidator to make demands for financial contributions from the members of a freehold management company if the terms of the articles of association of the freehold management company contain provisions requiring the payment of contributions.

level of indebtedness of the association and ensure that creditors are not unduly affected by the limits placed on liquidators: paragraph 19.120.

1.103 Under the current law, the court is able to make an order permitting a successor association to take on the functions of the insolvent commonhold association. It is not, however, clear under the current law how such a succession order might operate. We recommend that there should be a rebuttable presumption that the court will grant a succession order to permit a successor association to take on the role and function of an insolvent commonhold association: paragraph 19.117. To support the successful operation of the commonhold association, we recommend giving the court a discretion to impose conditions on the grant of a succession order; for example, by prohibiting directors of the insolvent association from acting for the successor: paragraph 19.118. However, to ensure that unit owners' limited liability is not undermined, it should not be possible for the court to require financial contributions from unit owners as a condition of granting a succession order: paragraph 19.121.

## **Chapter 20: Voluntary termination of commonholds**

1.104 One of the advantages of commonhold is that, unlike leasehold, it offers a structured process to deal with the end of a building's useful life. Unit owners will be in control of the decision to bring the commonhold to an end, and there are procedures in place to achieve this. Unit owners may vote to terminate the commonhold so that the commonhold can be sold and the proceeds of sale divided between them. Voluntary termination may be appropriate where the building is in need of redevelopment or where the owners receive a lucrative offer to buy the site.

1.105 Under the current law, voluntary termination may proceed with the support of 80% of unit owners and the approval of the court. While it must approve the terms of the termination, the court currently has no jurisdiction to prevent the termination from taking place. Given that termination could result in unit owners' properties being sold without their express agreement, we recommend that the court should have greater powers to protect the minority. We recommend that 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: paragraph 20.43.

1.106 The CCS may specify the shares of the proceeds of sale that each unit owner is to receive if the commonhold is terminated. There is potential for those shares to become out of date as the commonhold ages and circumstances change. Unit owners may feel that pre-determined shares are no longer fair. We recommend that unit owners should be able to apply to the Tribunal to challenge and overturn pre-agreed shares: paragraph 20.145. The Tribunal will examine all the relevant circumstances to assess whether the shares should be changed.

1.107 We also make a number of recommendations to protect the interests of mortgage lenders during termination. We ensure that funds owing to a lender are not used to discharge other mortgages within the commonhold: paragraph 20.75. Our recommendations will provide lenders with the same level of protection as they enjoy when lending on other residential property. We recommend that lenders should have the right to apply to court at any time during the termination process to protect their interests: paragraph 20.85. This offers protection to lenders where they suspect that a termination is not being conducted properly, or that the units are being undervalued.

And we recommend that liquidators (who will have conduct the termination) should have to give a new statement of truth confirming that they have complied with all statutory requirements in conducting the termination: paragraph 20.76. A lender would be able to pursue a liquidator who has acted improperly and prejudiced the lenders' interests.

1.108 Finally, we recommend provision to terminate part of a commonhold. Our Report makes recommendations that will enable mixed-use commonholds to operate successfully (see Chapter 8). However, the life-span of residential and commercial property often varies, and commercial property is likely to be in need of redevelopment long before residential property. We recommend a bespoke procedure so that part of a commonhold can be terminated and removed for development to ensure the long-term success of mixed-use commonhold developments: paragraph 20.203.