



21 July 2020

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

Today the Law Commission has published its report on Reinvigorating Commonhold: the alternative to leasehold ownership.<sup>1</sup>

Commonhold offers inherent advantages to lenders over leasehold. Because commonhold is freehold, there is no risk of forfeiture, and the units are not wasting assets. The superiority of commonhold is reflected in experiences overseas. In many countries, leasehold home ownership does not exist. Instead, equivalent systems to commonhold are used so that flats can be owned on a freehold basis. These systems are underpinned by the easy availability of mortgage finance. However, lenders have expressed legitimate concerns over some aspects of commonhold in this jurisdiction.

The support of mortgage lenders is vital to the success of commonhold. Therefore, in preparing our report, ensuring that commonhold is acceptable to lenders has been one of our key policy aims. We are confident that our recommendations ensure that commonhold units provide improved security to lenders than that offered by leasehold properties. In this open letter, we outline the steps we have taken to address concerns raised with us by and on behalf of mortgage lenders during our work on commonhold.

## **Enforcing financial breaches of the commonhold community statement**

The failure of a unit owner to contribute to the shared costs has the potential to prejudice other unit owners and their lenders. It is therefore vital that the commonhold association can recover contributions from unit owners towards the commonhold's expenditure. In our Consultation Paper we suggested that the commonhold association could have a first charge over each unit as a means of securing payment. Lenders expressed concern at the impact of this first charge on the security of a mortgage. We listened to that concern and we recommend a different solution. Instead of a charge, we recommend a new power for the commonhold association, subject to a number of safeguards, to apply to court for the sale of a defaulting owner's unit in order to recover arrears. We have modelled this new power on a similar power recommended by the Law Commission in its report on Termination of Tenancies for Tenant Default<sup>2</sup> – an approach which has already received the acceptance of lenders.

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<sup>1</sup> Our full report, together with summaries, can be found at <https://www.lawcom.gov.uk/project/commonhold/>. In this letter, we refer to paragraph numbers to help you to find more detail of the matters referred to. Those paragraph numbers are references to paragraphs in the Report.

<sup>2</sup> Termination of Tenancies for Tenant Default (2006) Law Com No 303.

## **A lender's stake in the building**

We recognise that the value of a lender's security is inherently linked to the management and maintenance of the building in which a flat is located. A failure to keep the building in repair, to insure it properly, or to keep sound finances all have significant potential to jeopardise the value of a lender's security

We therefore recommend that lenders should be able to apply to the First-tier Tribunal (Property Chamber) in England or the Leasehold Valuation Tribunal in Wales ("the Tribunal") for the appointment of professional directors where no unit owners are willing to serve.<sup>3</sup> We also recommend that lenders should be able to apply to the Tribunal for the appointment of a professional director where the elected directors are persistently failing to comply with their obligations in the commonhold community statement ("CCS"), such as keeping the building in repair.<sup>4</sup> This represents a significant new tool for lenders to protect the value of their security when lending on commonhold units.

## **Insolvency of the commonhold association**

Presently, if a commonhold association becomes insolvent and is wound up, the commonhold structure comes to an end and the units become "flying freeholds". We acknowledge that lenders have a legitimate concern over this outcome because the value of their security would be reduced.

Our recommendations aim to ensure that the insolvency of commonhold associations rarely occurs; and in the unlikely event it does, that the value of lenders' security is protected by preserving the commonhold structure and preventing the units from becoming flying freeholds.

Our recommendations to prevent the insolvency of commonholds include:

- (1) making it compulsory for commonhold associations to take out public liability insurance;<sup>5</sup>
- (2) making it compulsory for commonholds to have a reserve fund and protecting the funds from the claims of creditors unrelated to the purposes of the fund;<sup>6</sup>
- (3) enabling unit owners to approve annual budgets. As unit owners are responsible for the commonhold's expenditure, increasing unit owner engagement creates a further incentive to keep costs affordable;<sup>7</sup> and

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<sup>3</sup> See paras 12.12 to 12.35.

<sup>4</sup> See paras 12.36 to 12.71.

<sup>5</sup> See paras 12.129 to 12.143.

<sup>6</sup> See paras 14.3 to 14.11.

<sup>7</sup> See paras 13.4 to 13.31.

- (4) making it easier for the association to recover unpaid contributions from unit owners.<sup>8</sup>

In those instances – which we expect to be rare – where a commonhold does become insolvent, we make provision to protect a lender’s security. We recommend that there should be a presumption that the court will appoint a successor association to replace the insolvent association.<sup>9</sup> Accordingly, in almost all cases of insolvency, the commonhold structure will be preserved by the appointment of a successor association. Our recommendation helps avoid the possibility that the units become flying freeholds, therefore preserving the value of the lender’s security.

### **Voluntary termination**

Voluntary termination enables unit owners to decide whether the commonhold structure should be dissolved. It provides a structured process to deal with the end of a building’s economic life. Our Report makes a number of recommendations to ensure that lenders are protected during this process and are able to take action to protect their security when it is necessary to do so.

First, we ensure that the redemption of mortgages on commonhold units following a voluntary termination operates in the same way as on any sale of mortgaged property: the lender is repaid from the funds allocated to the individual unit on which they have lent.<sup>10</sup>

Second, lenders expressed particular concern over the status of their security during the termination process.<sup>11</sup> Voluntary termination requires that the commonhold units are transferred to the commonhold association. However, the transfer of the units to the association will not alter the fact that all mortgages remain registered against their respective titles. The current law ensures that they remain in place following the transfer.<sup>12</sup> Lenders should be in no doubt that their interest is protected during the termination process.

Finally, we recognise that lenders have a legitimate interest in how the termination process is conducted. They may wish to raise concerns about issues that affect the value of their security, or actions that may diminish the funds available to repay them, such as an improper valuation. Our recommendations provide lenders with an automatic right to make applications to the court during the termination process with a view to protecting their interests.<sup>13</sup> To ensure the effectiveness of this right, we recommend that commonhold associations should be required to notify mortgage lenders and other secured lenders on passing a termination resolution.<sup>14</sup> We have heard concerns about

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<sup>8</sup> See Chapter 18.

<sup>9</sup> See paras 19.71 to 19.122.

<sup>10</sup> See paras 20.58 to 20.76.

<sup>11</sup> See the Call for Evidence issued prior to the Commonhold Consultation Paper, para 7.13(1).

<sup>12</sup> Land Registration Act 2002, s 28(1).

<sup>13</sup> See paras 20.77 to 20.85.

<sup>14</sup> See paras 20.95 to 20.96 and para 20.106.

the potential for the remuneration of a liquidator diminishing the funds available to repay lenders. We acknowledge this concern and we have extended the right to challenge the remuneration of the liquidator to include lenders as well as unit owners.<sup>15</sup>

### **Responding to emergencies**

The Grenfell Tower fire resulted in a tragic loss of life. The significant difficulties experienced in buildings with cladding following the fire have provided a stark example of the impact that arises where a building requires emergency repair or remedial work.

Our recommendations ensure that a commonhold can raise emergency funds, either by borrowing on the security of its common parts, or by selling part of the common parts (such as a garden). The ability of commonholds to do so is essential for the unit owners and their lenders alike. We sought consultees' views on whether the consent of a lender to the creation of a charge required by a mortgage contract should be capable of being overridden. We have listened to lenders' objections to this possibility, and modified our recommendation accordingly. Under our recommendations, if a commonhold proposes to create a charge or sell part of its common parts, and a mortgage is secured against any unit, the proposed charge or sale will always require the approval of the Tribunal. Lenders will therefore be able to raise objections which the Tribunal would consider when making its decision. We consider that this will offer lenders an appropriate degree of protection.

### **Conversion to commonhold**

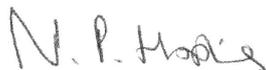
Our view is that commonhold units provide lenders superior security to that offered by leasehold flats. Therefore, we think that it ought, in principle, to be possible for charges to transfer automatically from the leasehold property to the commonhold unit.

However, we recognise the concerns that lenders have raised with us over the automatic transfer of their security. We therefore recommend that Government works with lenders to facilitate the automatic transfer of charges from the leasehold title to the commonhold unit title on conversion.<sup>16</sup>

### **Conclusion**

We have listened to the legitimate concerns raised by mortgage lenders on aspects of the current law that governs commonhold. We are confident that our recommendations ensure that commonhold units provide superior security to lenders than leasehold properties and we commend them to the sector.

Yours faithfully,



### **Professor Nick Hopkins**

Commissioner, Property, Family and Trust Law

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<sup>15</sup> See paras 20.97 to 20.100 and para 20.107.

<sup>16</sup> See paras 4.99 to 4.116.