



**Law
Commission**
Reforming the law

Commonhold: A Call for Evidence

22 February 2018



**Law
Commission**
Reforming the law

Commonhold: A Call for Evidence



© Crown copyright 2018

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: mpsi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at www.gov.uk/government/publications.

Any enquiries regarding this publication should be sent to us at enquiries@lawcommission.gov.uk.

THE LAW COMMISSION – HOW WE CONSULT

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

Topic of this call for evidence: Commonhold. This call for evidence invites views on the aspects of commonhold law that need to be improved in order to reinvigorate commonhold. The paper also asks consultees open questions about their experience of commonhold and how it compares with leasehold.

Geographical scope: This call for evidence applies to the law of England and Wales.

Availability of materials: The call for evidence is available on our website at <https://www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/>.

Duration: The call for evidence is open until **Thursday 19 April 2018**.

An optional response form is available at <https://www.lawcom.gov.uk/project/residential-leasehold-and-commonhold/>.

Alternatively, comments may be sent:

By email to: propertyandtrust@lawcommission.gov.uk

By post to: Rachel Preston, Law Commission, 1st Floor, Tower, 52 Queen Anne's Gate, London, SW1H 9AG.

Tel: 020 3334 5333 / Fax: 020 3334 0201

If you send your comments by post, it would be helpful if, whenever possible, you could also send them electronically.

After the call for evidence: We will use the views and evidence received during this call for evidence to assist us in preparing a detailed consultation paper. This consultation paper will be published later this year and will set out proposals for the reform of commonhold. At Chapter 2, Section D of this call for evidence we ask a question which addresses wider issues surrounding the reinvigoration of commonhold, such as the need to raise consumer awareness. These wider issues will be considered by Government, rather than by the Law Commission. Any responses which relate to these wider issues being considered by Government will be shared with Government.

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

Information provided to the Law Commission: We may publish or disclose information you provide us in response to this call for evidence, including personal information. For example, we may publish an extract of your response in Law Commission publications, or publish the response in its entirety. We may also share any responses received with Government. Additionally, we may be required to disclose the information, such as in accordance with the Freedom of Information Act 2000. If you want information that you provide to be treated as confidential please contact us first, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic disclaimer generated by your IT system will not be regarded as binding on the Law Commission. The Law Commission will process your personal data in accordance with the Data Protection Act 1998.

Contents

	Page
THE LAW COMMISSION – HOW WE CONSULT	ii
CHAPTER 1: INTRODUCTION	1
Background	1
Our work so far	3
This call for evidence	3
Legislative history of commonhold	4
Overview of the current law of commonhold	6
Creating or converting to commonhold	7
Developers’ rights	8
Interests granted over the commonhold	8
Rights and obligations within commonhold	8
Dispute resolution	9
Termination	9
CHAPTER 2: ISSUES AFFECTING THE SUCCESS OF COMMONHOLD	10
Introduction	10
A. Difficulties creating or converting to commonhold	10
B. Making commonhold work for homeowners	12
Application of company law	12
Consumer protection in new developments	12
Degree of flexibility in the commonhold community statement	13
Commonhold costs	14
Dispute resolution	15
Voluntary termination	15
Enforcement and insolvency	15
C. Making commonhold work across the property sector	17
Lack of flexibility in the commonhold model	17
Incompatibility with shared ownership	19
Improved security for mortgage lenders	19
D. Wider issues creating a barrier to commonhold’s success	21
CHAPTER 3: GENERAL QUESTIONS	22

Chapter 1: Introduction

- 1.1 This call for evidence is the first step in the Law Commission's project to reform the law of commonhold.
- 1.2 In this introductory chapter, we set out the background to commonhold: what it is, why it was introduced and what its advantages are. We explain what we are seeking to achieve from this call for evidence and how the evidence obtained will be used in our law reform project.
- 1.3 For context, we also provide a brief summary of the legislative history of commonhold, together with an overview of the current law of commonhold.
- 1.4 In Chapter 2, we discuss the issues which may create a barrier to commonhold's success. We invite observations on whether these issues are problematic in practice and whether there may be other issues not referred to.
- 1.5 Finally, in Chapter 3 we ask some general questions about people's experiences of commonhold and how it compares to leasehold.
- 1.6 Later this year, we will launch a full consultation which will discuss, in detail, the technical legal reforms that may be necessary for commonhold to succeed. The purpose of this call for evidence is to obtain views and evidence which will guide that future consultation. We are not, at this stage, making proposals for reform.
- 1.7 The Law Commission's project will focus on the aspects of commonhold law which need to be improved in order for commonhold to succeed. At the same time, Government will separately be considering wider measures to reinvigorate commonhold, such as raising consumer awareness. Government has already confirmed its intention to remove some of the financial incentives for developers to prefer leasehold over commonhold.¹ At Chapter 2, Section D, we invite comments on what other steps could be taken to encourage the use of commonhold, which we will report on and share with Government.

BACKGROUND

- 1.8 Commonhold was introduced in 2002 as a new way to own property. Currently, leasehold is the main way of owning residential flats in England and Wales. This is for historical reasons, as explained further in the summary of commonhold's legislative history at paragraph 1.24. Commonhold is intended primarily to provide an alternative form of ownership to residential leasehold, although its potential is much wider.

¹ Department for Communities and Local Government, *Tackling unfair practices in the leasehold market: Summary of consultation responses and Government response* (December 2017).

- 1.9 The commonhold legislation² provides a structure for the ownership and management of separate, interdependent properties. It enables a person to own the freehold of a “unit” (such as a flat) within a building or development and become a member of a company which owns the shared areas and manages the commonhold.
- 1.10 Commonhold is equally capable of applying in a commercial context, for instance to regulate relations between individual shops in a retail park or offices in an office block.
- 1.11 Commonhold is presented as having a number of advantages over leasehold.
- (1) *Freehold ownership.* In a commonhold, interests in the units are capable of lasting forever. A lease, on the other hand, will expire at some point in the future and becomes unmortgageable towards the end of its term. It may therefore be necessary to pay the landlord to extend the lease, which can be expensive.
 - (2) *Standardisation.* Commonholds have standard rules and regulations which should make conveyancing simpler and cheaper. It should also be easier for homeowners to understand their rights and obligations and not be caught out by hidden, onerous terms.
 - (3) *Self-management by the flat owners.* Where flats are owned as leasehold, the management of the block of flats is often controlled by a landlord. The landlord may have different interests from the leaseholders. For instance, the landlord may see leasehold as an investment opportunity or a way of generating income. In a commonhold, however, the block is managed by a company made up of the unit owners. The interests of the unit owners and the company which manages the commonhold should therefore be the same.
- 1.12 Despite these apparent advantages, fewer than 20 commonholds have been created since the law came into force.³
- 1.13 There could be a number of reasons why commonhold has failed to gain popularity. In part, it may be related to a lack of incentives (financial or otherwise) for developers to change their practices and create commonholds. Commonhold’s failure may also be related to an unwillingness of mortgage lenders to lend on commonhold units. Additionally, commonhold is a relatively unfamiliar form of ownership and there may be a lack of consumer and sector-wide awareness.
- 1.14 However, these are only part of the problem. Stakeholders have advised us that there are a number of technical legal issues within the current commonhold model which create a barrier to its adoption.
- 1.15 Recently, interest in commonhold has risen in response to bad practices that have been reported within the leasehold sector. In particular, leaseholders have highlighted spiralling ground rents, onerous administrative and other fees imposed by landlords, and concerns over the poor management of blocks. At the heart of these concerns lie long-established criticisms of leasehold, including leaseholders’ lack of control.

² The main provisions governing commonhold are set out in the Commonhold and Leasehold Reform Act 2002, the Commonhold Regulations 2004 and the Commonhold (Land Registration) Rules 2004.

³ L Xu, “Commonhold Developments in Practice” in W Barr (ed), *Modern Studies in Property Law: Volume 8* (2015) p 332. The main provisions of the Act came into force on 27 September 2004.

- 1.16 We want to find out why commonhold has failed and propose reforms to reinvigorate it. Whilst it may be impossible for any system to resolve all of the practical problems associated with occupying shared premises, our aim is to produce a viable and preferred alternative to leasehold. This call for evidence is our first step towards reaching this objective.

OUR WORK SO FAR

- 1.17 On 11 July 2016, we launched a public consultation asking which areas of law should be included in our 13th Programme of law reform. We identified residential leasehold law as an area which might benefit from reform and sought views on the problems being faced in practice. We received over 150 responses to our consultation which supported a review of one or more aspects of residential leasehold law.
- 1.18 Whilst our consultation sought views on residential leasehold and did not specifically address commonhold, we received a number of responses which related to commonhold. We have also become aware of growing interest in commonhold, particularly through the work of the All-Party Parliamentary Group on Leasehold and Commonhold, and the Leasehold Knowledge Partnership.
- 1.19 In December 2017, we announced that our 13th Programme of law reform included a project on commonhold. Our commonhold project sits alongside a review of residential leasehold law, which will also include an examination of enfranchisement (which enables leaseholders to extend their lease or purchase the freehold) and the regulation of managing agents.

THIS CALL FOR EVIDENCE

- 1.20 As we have not to date canvassed views specifically on commonhold, we have decided to start this project with a call for evidence. We will not be carrying out a call for evidence in relation to enfranchisement as our 13th Programme consultation generated significant evidence on this topic. A separate call for evidence has already been carried out by Government in relation to the regulation of managing agents.
- 1.21 The responses received to our 13th Programme consultation, and other discussions of commonhold that have taken place, have been helpful in highlighting a number of problems with the existing commonhold model. In this paper, we set out these issues and invite observations.
- 1.22 We also want to know about any other problems or concerns not referred to in this paper. We are particularly keen to hear from those with experience of setting up or living in a commonhold, leaseholders, developers, conveyancers and mortgage lenders. Responses received will be invaluable in guiding our future consultation paper. For commonhold to succeed, it will need to work for everyone.

LEGISLATIVE HISTORY OF COMMONHOLD

- 1.23 Commonhold has a long legislative history in England and Wales. As far back as 1965, the Wilberforce Committee recommended the adoption of a new structure to regulate rights and obligations in blocks of flats and other multi-owned developments.⁴
- 1.24 In England and Wales, flats have almost universally been sold on a leasehold, as opposed to freehold, basis. That is because, for historic reasons, certain obligations to pay money or perform an action in relation to a property (such as to repair a wall or a roof) cannot legally be passed to future owners of freehold property.⁵ These obligations are especially important for the effective management of blocks of flats. For instance, it is necessary that all flat owners can be required to pay towards the costs of maintaining the block.
- 1.25 Whilst it is possible for flats to be granted on a freehold basis outside of the commonhold structure (known as “flying freeholds”), freehold ownership of flats creates a number of problems in practice. In particular, as flats are structurally interdependent, the failure of certain owners to repair their flat could cause significant damage to other owners’ properties. However, once a freehold flat has been sold for the first time, the subsequent owners will generally not be under an obligation to repair their property. Flats have therefore been granted on a leasehold basis which allows repairing (as well as other) obligations to be transferred to future owners.
- 1.26 By the time of the Wilberforce Report in the 1960s, most other common law jurisdictions had structures in place which allowed flats to be owned on a freehold basis: for instance, “strata title” in Australia and “condominium” in America. In these countries, however, flats were never commonly owned as leasehold. Forms of ownership other than leasehold had existed, but it appears that these were not acceptable to mortgage lenders. One of the main driving forces behind the introduction of strata title and condominium overseas was therefore to provide a form of ownership that was attractive to lenders.
- 1.27 By contrast, in England and Wales, the main advantage of introducing commonhold was to provide an alternative form of ownership to leasehold. Whilst leasehold has been generally accepted by mortgage lenders, homeowners have often been dissatisfied with this form of ownership.
- 1.28 In 1985, the Nugee Report highlighted growing dissatisfaction with leasehold as a form of ownership.⁶ In particular, concerns were raised about poor management and excessive service charges in blocks of flats.

⁴ Report of the Committee on Positive Covenants Affecting Land (1964-65) Cmnd 2719, chaired by Lord Wilberforce.

⁵ The Law Commission has proposed the creation of a new interest in land (“the land obligation”) which can be positive or negative and will bind future owners of the land. However, the needs of freehold flats and other multi-occupancy developments will not be met satisfactorily by this new land obligation: Making Land Work (2011) Law Com No 327 paras 1.10, 5.17, 5.18, 5.90 and 5.91.

⁶ Report of the Committee of Enquiry on the Management of Privately Owned Blocks of Flats (1985), chaired by Edward Nugee QC.

- 1.29 The following year, in 1986, Government asked the Law Commission to set up a working group to recommend a new scheme which would regulate relations between separate, interdependent properties. This working group was headed by Trevor Aldridge and its report has become known as the “Aldridge Report”. Although Trevor Aldridge was a Law Commissioner, the report was prepared independently of the Commission following consultation with a selected group of interested bodies.
- 1.30 The Aldridge Report was published in 1987 and proposed the introduction of “commonhold”. The working group chose this name as it seemed to convey “both the notion of land ownership” and the “element of community of interests and co-operation in management” intrinsic to the scheme.⁷
- 1.31 It is clear that the task of turning the recommendations in the Aldridge Report into legislation was not an easy one. A succession of consultations and draft Bills followed before the Commonhold and Leasehold Reform Bill was introduced into Parliament in 2001. The Act received Royal Assent in May 2002 and the main provisions came into force on 27 September 2004.
- 1.32 The commonhold structure created in 2002 follows the same basic structure proposed in the Aldridge Report. It comprises:
- (1) separate parts of a building (such as flats within a block) or separate buildings (such as houses on an estate) individually owned on a freehold basis;
 - (2) a management body composed of the unit owners; and
 - (3) mutual rights and obligations imposed by statute.
- 1.33 In other respects, however, commonhold differs from the recommendations of the Aldridge Report. For example, the Report suggested that unit holders should be able to grant leases of any length. Under the current legislation, in contrast, it is not possible for unit holders to grant a residential lease of longer than seven years. The Aldridge Report also proposed the creation of a new kind of corporate body to manage the commonhold, which would not be subject to general company law. This is different from the current position where the commonhold is managed by a private company limited by guarantee.
- 1.34 The Aldridge Report left open the question of whether it should be possible to convert from leasehold to commonhold without the consent of the freeholder and all leaseholders. Under the current commonhold legislation, unanimity is required to convert from leasehold to commonhold – an issue which continues to be a key source of difficulties.

⁷ Commonhold: Freehold flats and the freehold ownership of other interdependent buildings (1987) Cm 179 preface, para 3.

OVERVIEW OF THE CURRENT LAW OF COMMONHOLD

1.35 The main provisions which govern commonhold are contained in:

- (1) the Commonhold and Leasehold Reform Act 2002 (“the Act”);
- (2) the Commonhold Regulations 2004 (“the Regulations”); and
- (3) the Commonhold (Land Registration) Rules 2004 (“the Rules”).

1.36 The Regulations provide much of the detail of how commonhold operates. They set out terms which must be adopted in every commonhold, referred to below as “prescribed terms”. These terms create a level of consistency across all commonholds. As many of the terms will be the same in every commonhold, conveyancing should be made quicker and easier. It should also make it easier for homeowners to understand their rights and obligations.

1.37 A commonhold is made up of the following key elements.

- (1) *Commonhold units.* A unit is a separate, individually owned property (such as a flat) or area of land within a larger building or development. The freehold of the unit will be held by a “unit holder”. The unit may form part of a larger building, such as a flat within a block of flats or offices within an office block. It is also possible for a commonhold unit to be a separate building within a larger development. For instance, houses on an estate with shared gardens could be units, as could individual shops within a retail park. Even an area of land not connected to a building could be a unit, such as a car parking space.
- (2) *Common parts.* A common part is any area of the commonhold which does not form part of a commonhold unit. Common parts in a block of flats could include, for instance, entrance halls, landings and communal staircases.
- (3) *A commonhold association.* The commonhold association is a private company limited by guarantee which owns the common parts and manages the commonhold. The association must have at least two directors who carry out the management functions of the commonhold. Unit holders will be the members of the association and will be able to vote in decisions which affect the scheme.
- (4) *Articles of association.* These are the rules which govern how the commonhold association operates and how management decisions about the commonhold can be made. For example, the articles will set out how directors are appointed and what their duties are, how meetings of members are to be called, and how members’ votes are cast. The articles are prescribed by the Regulations but there is some flexibility to amend them to better suit the needs of the particular scheme.
- (5) *Commonhold community statement.* The statement is the document which defines the physical boundaries of the commonhold units. The statement also sets out the rights and obligations of unit holders and the commonhold association. As an example, the commonhold community statement will set out unit holders’ voting rights and their requirement to contribute towards the costs of the commonhold. Again, the contents of the statement are largely prescribed by the Regulations. An advantage of the community statement is that the main rights and obligations of all unit holders in the commonhold will be the same and set out in the same document (with some scope for different voting rights and financial contributions to be allocated to different units). This position differs from that in a block of flats where the individual flat leases may contain terms which are different to each other.

Creating or converting to commonhold

- 1.38 A commonhold can be created as a new development, or one or more existing buildings can be converted to commonhold. The first step in either case is to apply to HM Land Registry to register the land as commonhold. Only the freehold owner of the land can make this application. As a result, where leaseholders in a block of flats wants to convert to commonhold they would first need to buy the freehold, unless the freeholder agrees to apply on their behalf.
- 1.39 Before applying to register the commonhold at HM Land Registry, it is necessary to obtain the consent of a number of people who own an interest in the land. In addition to the freeholder, anyone who owns a lease of over 21 years (and certain owners of leases under 21 years) must consent. The consent of every lender who holds a mortgage over the whole or part of the land must also be obtained.
- 1.40 Additionally, before making the application, the person applying to HM Land Registry must set up the commonhold association, prepare the articles of association and commonhold community statement. In the case of a new commonhold development, it will often be the developer who prepares the initial commonhold documentation.
- 1.41 The consequences of registering the land as commonhold will depend on whether the commonhold is being created as a new development or whether one or more buildings are being converted to commonhold.
- (1) *When existing buildings are converted*, the identity of the owners of the commonhold units will already be known. For instance, on the conversion of a block of flats, the leaseholders will become the owners of the commonhold units. On registration, these individuals will each become the freehold owners of their particular commonhold unit. The commonhold association will be registered as the owner of the common parts and the commonhold community statement will come into force. All leases and all mortgages over these leases will come to an end on registration. It is therefore likely that a mortgage lender will only consent to the conversion if the leaseholder agrees for the mortgage to be re-granted over the commonhold unit after conversion.
 - (2) *When new commonhold developments are being created*, the individual owners of the units will not be known at the outset. The developer will be registered as the owner of all the commonhold units and the common parts. The registration of the land as commonhold will trigger a “transitional period” which ends when the first unit is sold. During this transitional period, the commonhold community statement will not be in force and the developer will own and control the commonhold. Once a unit is bought, the commonhold association will be registered as the owner of the common parts. The commonhold community statement, which governs the relationship between the association and all unit holders, will also come into force. On the sale of a unit, the purchaser will be registered as the owner of that unit. The purchaser will also become entitled to be member of the commonhold association. The developer will continue to be a unit holder in respect of remaining unsold units.

Developers' rights

- 1.42 During the transitional period of a new development (see paragraph 1.41(2)), the person creating the commonhold (usually the developer) will own all the commonhold land and will have a large degree of control over the commonhold. After the transitional period has ended, this flexibility can be significantly limited by provisions of the Act, and by the commonhold community statement which then comes into effect. It is, however, possible for the developer to reserve certain rights to complete works, amend the commonhold community statement and appoint directors in the post-transitional phase.

Interests granted over the commonhold

- 1.43 The Commonhold Act and Regulations restrict the interests that may be granted over the commonhold land. In particular, it is not possible for unit holders to grant a residential lease of their units for more than seven years or for a premium (a one off initial payment payable at the point of sale, in addition to any rent due under the lease). Additionally, it is only possible for the commonhold association to grant a mortgage over the common parts following a unanimous members' vote in favour.

Rights and obligations within commonhold

- 1.44 The commonhold association is responsible for calling meetings and making decisions which affect the management of the commonhold scheme. Directors must use their management powers to prevent unit holders from being disrupted in their homes and help them to exercise their rights. For example, if a unit holder's breach of the commonhold community statement causes disruption, the directors should take enforcement action against the unit holder, unless it would not be in the best interests of the commonhold to do so.
- 1.45 The commonhold association is responsible for repairing and maintaining the common parts. These responsibilities include decorating the common parts and "putting them in sound condition". The association must also insure the common parts to their full rebuilding value.
- 1.46 The unit holders are responsible for contributing towards the "commonhold assessment". The assessment is a sum demanded by the commonhold association to meet the costs of the commonhold, such as keeping the common parts in repair. Contributions to the assessment will be divided between the units in the percentages allocated by the commonhold community statement. Unit holders have a right to make observations about the sums demanded and the directors have a duty to consider them. If a unit holder does not pay the sums requested on time, the association is entitled to charge interest.
- 1.47 Directors may also set up and demand contributions towards a reserve fund which helps spread the costs of future works.
- 1.48 Unit holders have the right to vote on a number of decisions affecting the commonhold, including alterations and additions to the common parts and the appointment of directors. Each unit will be allocated a percentage of votes, which will be specified in the commonhold community statement. Where a vote is taken by show of hands, each member attending will have one vote. Where a poll is demanded, members will have the number of votes allocated to their unit in the commonhold community statement.

1.49 Commonhold rights and obligations attach to the unit rather than the person. This ensures the rights and obligations bind future owners of the commonhold units.

Dispute resolution

1.50 The commonhold community statement includes a procedure which must be followed before legal proceedings can be commenced between a unit holder and the commonhold association (or between two or more unit holders). In every case, the complainant must first consider whether it might be possible to resolve the dispute through negotiation or a form of alternative dispute resolution such as arbitration, mediation or conciliation. The Act also provides for the creation of an “approved ombudsman scheme” to facilitate disputes between unit holders and the commonhold association. However, no such scheme has ever been created.

Termination

1.51 A commonhold may be ended in a number of ways, including the following.

- (1) *By the developer cancelling the registration of land as commonhold during the transitional period of a new development.*
- (2) *By an order of the court where the formality requirements for creating the commonhold have not been followed, or where the commonhold community statement and/or articles do not comply with the Act or Regulations.*
- (3) *By the members of the commonhold association (the unit holders) where the association is solvent (able to pay its debts) and 80% of members support the termination. At least 80% of the members must also approve a “termination statement”. This document sets out how the commonhold land and other property should be distributed after the commonhold ends. On termination, the commonhold association will become the owner of all the commonhold land including the units. The land and property will then be distributed in accordance with the terms of the termination statement.*
- (4) *By the court on receipt of an application to wind up (bring to an end) the commonhold association. An application may be made in a number of circumstances, including where the association is unable to pay its debts. If the court decides that the association should be brought to an end, the common parts of the association will be sold, unless the court makes a “succession order.” A succession order transfers the common parts and the association’s management responsibilities to a new successor company.*

1.52 It has been argued that the current law of commonhold, as summarised above, contains a number of problems which need to be addressed in order for commonhold to succeed. These issues are discussed in Chapter 2.

Chapter 2: Issues affecting the success of commonhold

INTRODUCTION

- 2.1 We are aware of a number of issues which could create a barrier to commonhold's success. In this chapter, we set out these issues and invite observations.
- 2.2 The Law Commission will be focussing on aspects of commonhold law which need to be reformed in order to reinvigorate commonhold. At the same time, Government will be considering other measures to improve the take up of commonhold.
- 2.3 The legal issues to be considered by the Law Commission fall within three broad categories:
- (1) *Issues in the process of creating or converting to commonhold.* For commonhold to succeed, there needs to be an effective way to create new commonhold developments or convert existing buildings to commonhold.
 - (2) *Issues which may make commonhold unattractive to homeowners.* If commonhold is to provide a preferred alternative to residential leasehold, it needs to work well for homeowners.
 - (3) *Issues which may make commonhold unattractive across the wider property sector.* For commonholds to be built and be saleable, the law must also work for developers, mortgage lenders and across the wider property sector.
- 2.4 In addition to these legal issues, Government will be considering a fourth category of wider issues which create a barrier to commonhold's success.
- 2.5 Each of these categories will be discussed in turn. We will then ask a number of questions which invite views and evidence on whether the issues raised create a problem in practice and whether there may be other issues not referred to.

A DIFFICULTIES CREATING OR CONVERTING TO COMMONHOLD

- 2.6 A commonhold can be created as a new development. Alternatively, existing buildings can be converted to commonhold (for example, a block of flats where the flats are held on leases).
- 2.7 In order to create or convert to commonhold, particular processes need to be followed. These processes are summarised at paragraphs 1.38 to 1.41 of this call for evidence. We are not aware of any difficulties caused by these processes where a commonhold is created as a new development. We would, however, be interested to hear the experiences of anyone who has set up a new commonhold or has considered doing so.

- 2.8 On the other hand, stakeholders have told us that it is almost impossible for existing buildings to be converted to commonhold. The key difficulty in converting is that most people who own an interest in the land must consent to the conversion.
- 2.9 As an example, to convert an existing block of flats from leasehold to commonhold, the consent of the freeholder and all leaseholders owning a lease of over 21 years would need to be provided. Additionally, it would be necessary to obtain the consent of every lender who has a mortgage over any of the flats in the block.
- 2.10 It is only possible for the court to remove the requirement to obtain a particular consent where the person cannot be identified, traced or where the person fails to respond to a request for consent.

Question 1.

(a) **If you have previously tried to convert to commonhold:** Did the requirement to obtain everyone's consent prevent you from converting to commonhold? What was your experience and what difficulties did you come across?

(b) **If you have never tried to convert to commonhold:** Do you think the requirement to obtain everyone's consent would prevent you from converting to commonhold in your building or development? If so, why and what difficulties could you foresee?

Please provide details about your particular building or development, for instance the number and type of units (such as flats) within each building.

Question 2.

Are you aware of any difficulties in the process of creating a commonhold as a new development or any other difficulties in the process of converting to commonhold (other than the consent requirement)?

Please give as much detail as you can.

B MAKING COMMONHOLD WORK FOR HOMEOWNERS

2.11 We have been made aware that the following issues may need to be reconsidered if commonhold is to work for those owning commonhold units as their homes (referred to in this section as “homeowners”).

(1) Application of company law

2.12 The commonhold association is a company which is governed by company law as well as by commonhold legislation. Company law contains numerous, detailed rules that must be followed and documents that must be lodged each year. Directors are responsible for ensuring that these company law requirements are met.

2.13 Some stakeholders have suggested that the commonhold association should not be a company subject to general company law. They argue that company law rules are unnecessarily complicated for commonhold associations. The consequences of failing to comply with company law rules, which include criminal liability, may also be too harsh. Instead, it has been suggested that a bespoke corporate structure should be created for commonhold associations.

2.14 Other stakeholders suggest that the commonhold association should remain a company subject to general company law. However, they argue that the law is too complex and unclear in its application to commonhold associations. Concerns in relation to complexity and a lack of clarity are especially concerning as it is the homeowners who will be the members of the association and often the directors. These homeowners may have limited knowledge of company law, or experience of acting as a director. Additionally, the conveyancers helping homeowners to buy commonhold units are unlikely to be company law specialists. It has been suggested that more guidance and clarity in this area would therefore be desirable.

2.15 Leaseholders are able to set up companies to own and/or manage their building (such as right-to-manage companies). These companies are also subject to company law. We would be interested to hear from those with experience of such companies to find out whether the application of company law has been problematic in practice.

(2) Consumer protection in new developments

2.16 Before any units in a new commonhold development have been sold, the developer will be able to enter into long-term contracts on behalf of the commonhold association. For instance, the developer could appoint someone to manage the commonhold and keep the common parts in repair. Stakeholders have argued that homeowners should have more control over these contracts, particularly as they may bind the association for long periods of time.

2.17 The developer will also be responsible for deciding how the costs of the commonhold and voting rights should be shared between the units. Although unit holders can vote to change this allocation, we have been told that developers may be able to retain the majority of votes and therefore prevent certain decisions from being passed.

2.18 Developers can sell units in a new commonhold before the rest of the development is complete. Developers can then reserve rights to enable them to complete the works by adding “developers’ rights” to the commonhold community statement

(see paragraph 1.42 above). For example, developers may sell units in one building to finance the construction of another building. Developers would want to reserve the right to access areas of the commonhold necessary for the construction to take place. Developers may also want to reserve the right to put up scaffolding on the existing building or erect signs to market the new units. Additionally, developers may want to reserve the right to amend the commonhold community statement if the construction will change the physical boundaries of the commonhold.

2.19 It is important that developers are given sufficient flexibility to enable works to be completed. However, we are aware of concerns that the right balance has not been struck between affording flexibility to developers and protecting homeowners from potential abuse of power.

(3) Degree of flexibility in the commonhold community statement

2.20 The commonhold community statement describes the physical boundaries and facilities within the commonhold. It also sets out the rights and obligations of the unit holders and the commonhold association.

2.21 Certain terms of the statement must be the same in every commonhold and cannot be changed. These terms ensure that the commonhold meets minimum standards. The inclusion of standard terms can also make it easier for homeowners to understand their rights when buying commonhold property.

2.22 Other terms can be changed or added to, either at the time the community statement is created, or at a later date. The ability to change or add to the statement gives unit holders some flexibility to tailor the statement to the needs of the particular commonhold. Homeowners may, for instance, agree to introduce rules to ban pets or to install or remove certain facilities or services, such as the use of a door entry system or CCTV.

2.23 We have been told that the statement does not always achieve the right balance between terms which apply to all commonholds and those which can be changed to meet the needs of the particular commonhold.

2.24 In some areas, it is argued that more flexibility would be desirable. As an example, each commonhold association is required to put the common parts in a "sound condition". It has been suggested that there should be more flexibility for each commonhold to decide the extent of the association's repairing obligations, taking into account the age of the building and how expensive it is to live there.

2.25 In other areas, there may be too much flexibility given to the individual commonhold. For example, it is currently only a requirement for commonhold associations to insure against the risk of fire. Each commonhold can then decide whether to insure against other risks. It has been suggested that that all associations should be required to insure against a number of other risks, such as flooding.

2.26 We are also aware of concerns that if there is too much flexibility, a homeowner may end up living in a building with different rules and paying for different facilities from when they bought the property.

(4) Commonhold costs

2.27 Homeowners will be required to contribute towards the costs of maintaining and managing the commonhold (for example, the cost of repairing the roof or paying a caretaker). The share to be paid by each homeowner is set out in each commonhold's community statement. This share will be the same regardless of what the cost relates to. We have been told that this is not flexible enough and that it should be possible to split costs in a way that better reflects actual use of services and facilities.

Example:

There is a commonhold building with a shop on the ground floor, one flat taking up the entire first floor and two flats sharing the second floor.

When the commonhold was set up, it was decided that the first floor flat and shop owners should pay slightly more than the other units.

The commonhold community statement therefore allocates the commonhold expenses in the following way:

- Shop and Flat 1: 30% each of the commonhold costs.
- Flats 2 and 3: 20% each of the commonhold costs.

Figure 1:

Flat 2: 20%	Flat 3: 20%
Flat 1: 30%	
Shop: 30%	

This allocation means that when the roof of the building needs repairing, the shop and first floor flat owners will be required to pay 30% each of the cost, whilst the owners of flats 2 and 3 will pay 20% each.

Outside the building there is a small car park with 10 spaces. Each flat has one allocated parking space, and the remaining seven spaces are allocated to the shop.

Figure 2:

Flat 1	Flat 2	Flat 3	Shop						
--------	--------	--------	------	------	------	------	------	------	------

Even though the shop has seven spaces (70% of the car park) and the flat owners only have one each (10% each), the cost of maintaining the car park must be shared in the same way as the cost of repairing the roof. The shop and first floor flat owners both pay 30% of the cost and flats 2 and 3 will pay 20% each.

It has been argued that there should be flexibility to split the costs in a way that better reflects actual usage – in this case, so that the shop owner pays 70% of the cost of maintaining the car park, with the owners of flats 1, 2 and 3 each contributing 10%.

- 2.28 The directors of the commonhold association will be responsible for deciding how much money should be spent on managing and maintaining the commonhold. Whilst directors will generally be appointed by the homeowners, there is a concern that homeowners will have limited say on how their contributions will be spent. It is also argued that there are insufficient remedies available to protect homeowners against unreasonable costs being charged.
- 2.29 Additionally, we have been told that homeowners may become responsible for paying commonhold costs incurred before they bought the property which they were not aware of at the point of sale.

(5) Dispute resolution

- 2.30 The commonhold community statement sets out a procedure to resolve disputes between homeowners and the commonhold association (or between two or more homeowners). The parties must first try to resolve the dispute informally, for instance through negotiation. If the parties are unable to resolve the dispute, then a claim can be brought in the county court. Although the law provides for the creation of an ombudsman scheme to help resolve commonhold disputes, no such scheme has been set up. We have been advised that the current procedure is complicated and ineffective. We have also been told that it would be useful for a body other than the county court to assist with resolving disputes.

(6) Voluntary termination

- 2.31 As discussed at paragraph 1.51 above, one of the ways in which a commonhold can be terminated is by the agreement of at least 80% of the homeowners. We have been told that there is a lack of clarity over what happens when the commonhold ends. For instance, it is unclear whether homeowners can simply convert back to leasehold ownership if they want to.

(7) Enforcement and insolvency

- 2.32 We are aware of concerns that the current model might not do enough to prevent the commonhold from coming to an end due to insolvency (where the association is unable to pay its debts). In particular, it has been argued that the commonhold association does not have an effective way of recovering commonhold costs from unit holders, which puts the solvency of the scheme at risk. Additionally, we are aware of concerns that homeowners might not be adequately protected if the commonhold association becomes insolvent. For instance, we have been told there is a risk of homeowners becoming responsible for the entire debts of the commonhold association.
- 2.33 As discussed at paragraph 2.15 above, there are similarities between commonhold associations and leaseholder-owned companies which own and/or manage their building. We would be interested to receive evidence from anyone who has experience of a leaseholder-owned company becoming insolvent.

Question 3.

There are a number of issues which may need to be addressed to make commonhold work for homeowners. These include issues relating to:

- *Application of company law. Stakeholders tell us that company law is too complex and that the commonhold association may require a different corporate structure.*
- *Consumer protection in new developments. Stakeholders tell us that the right balance has not been struck between providing flexibility to the developer and protecting consumers.*
- *Degree of flexibility in the commonhold community statement. Stakeholders tell us that the right balance has not been struck between the terms which must apply to all commonholds and those which can be changed.*
- *Commonhold costs. Stakeholders tell us that there should be more flexibility in the way costs of managing and maintaining the commonhold can be shared.*
- *Dispute resolution. Stakeholders tell us that the dispute resolution procedure is ineffective and that a body other than the county court should assist with resolving disputes.*
- *Termination and insolvency. Stakeholders tell us that the law surrounding termination is unclear and that homeowners may not be adequately protected if the commonhold association becomes insolvent.*

(a) **If you have previous involvement with commonhold:** Have you encountered problems in practice relating to any of the above aspects of commonhold?

Please provide as much detail as you can about your experience.

(b) **If you have not had previous involvement with commonhold:** Have any of the issues above deterred you from using commonhold or would they deter you? If so, why?

(c) Are you aware of any issues not referred to above which might make commonhold undesirable for homeowners?

Please provide as much detail as possible.

Question 4.

There are similarities between commonhold associations and leaseholder-owned companies which own and/or manage their building.

If you have experience of a leaseholder-owned company:

(a) Has the application of general company law to leaseholder-owned companies caused any issues in practice?

(b) Do you have any experience of a leaseholder-owned company becoming insolvent? What was the situation, and to what extent (if at all) were the leaseholders responsible for paying the debts of the company?

Please give as much detail as possible.

C MAKING COMMONHOLD WORK ACROSS THE PROPERTY SECTOR

- 2.34 For commonhold to succeed it will need the support of all participants in the property sector, including developers, mortgage lenders, commercial tenants and landlords.
- 2.35 We noted at paragraph 1.13 that there may be a lack of incentives for developers to use commonhold, especially as leasehold can have certain financial advantages. Government will be looking more generally at how developers may be encouraged to use commonhold. At paragraph 2.48 we invite views on how this could be achieved.
- 2.36 The following paragraphs are only concerned with identifying aspects of commonhold law that need to be reviewed to ensure that developers' (and others') legitimate needs are met. We have been told that the following issues could make commonhold unattractive, particularly to developers and mortgage lenders.

(1) Lack of flexibility in the commonhold model

- 2.37 We have been told that there needs to be greater flexibility in how commonholds can be structured. We are aware that developers are increasingly looking to create "mixed-use" developments. These developments may include a residential element, such as flats, and one or more commercial elements, such as shops or offices. The development may also include entertainment or leisure facilities which are open to the public as well as those living in the flats and working in the shops or offices.
- 2.38 We have been told that one way to add flexibility would be to permit the creation of "layers" within a commonhold. This could involve each component part of a mixed-use development having its own commonhold association which would deal with issues specific to that part. For instance, there could be one commonhold association to manage the residential element of the development and another to manage the commercial element. There would then be an overarching "umbrella commonhold" which would cover the entire development and address issues common to the whole development.

Example:

A private estate is built with the following:

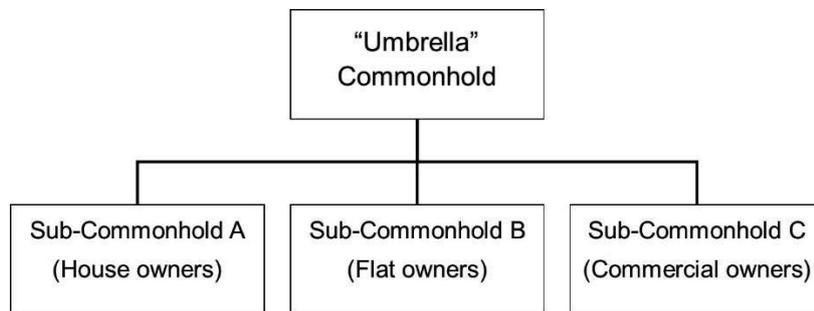
- (A) a large block containing 20 residential flats;
- (B) 20 detached houses;
- (C) a restaurant and a shop; and
- (D) a driveway and gardens shared between all the properties.

Commonhold could be used for this development. Under the current law there would be just one commonhold association, made up of the residential flat owners, the shop and restaurant owners, and the owners of the houses. All the costs would be shared between all the owners, and all the owners would be able to vote on all matters. This would be the case even if the matter in question only related to one group of owners (for example, deciding what colour to paint the staircases in the block of flats).

It might be more desirable to be able to create a “layered scheme” in the following way.

- (1) An “umbrella” commonhold association would be set up, which would deal with matters affecting all owners, such as the upkeep of the road and shared gardens.
- (2) Three sub-commonholds could then be created:
 - (a) one made up of all the house owners, dealing with issues relating only to the houses;
 - (b) one made up of all the residential flat owners; and
 - (c) one made up of the commercial owners.

This would create a commonhold structure as follows:



2.39 In addition, we have been told that more flexibility is required in both the way costs can be allocated and in the commonhold community statement. These concerns have already been referred to above in our discussion of issues making commonhold unattractive to homeowners at paragraphs 2.20 to 2.27. However, these are also issues which might deter developers from choosing commonhold over leasehold. In particular, the community statement has been criticized for not catering to the needs of particularly large, or particularly small, developments.

(2) Incompatibility with shared ownership

- 2.40 Shared ownership leases are granted by housing associations, generally for 99 or 125 years, to help people on low to moderate incomes purchase their homes. They enable a person to buy a percentage share in the ownership of a house or a flat (between 25% and 75%) and pay a reduced rent on the remaining share owned by the landlord. A person can then buy additional shares until they have bought 100% of the property.
- 2.41 Shared ownership plays a key role in Government's strategy to provide more affordable homes in England and Wales. Government has allocated funds to deliver 135,000 more shared ownership homes before 2021.⁸ Additionally local authorities require developers to allocate a certain percentage of units in new developments to affordable housing, such as shared ownership.
- 2.42 It is currently impossible for shared ownership leases to exist within commonhold. Shared ownership requires the grant of a long lease and, as noted above at paragraph 1.43, unit holders are prohibited from granting residential leases of their units for more than seven years. Consequently, where a development is intended or required to include a shared ownership element, it is currently impossible for the scheme to be built as commonhold. Unless shared ownership is catered for, the growth of commonhold may be significantly restricted.
- 2.43 Shared ownership is one of a number of schemes that has been used to provide affordable owned homes. Other schemes include shared equity, where a contribution to the purchase price is provided as a loan, secured as a second charge on the property, and rent to buy, where a property is initially rented on a short lease with an option to buy. We are not aware that the use of commonhold creates any particular difficulties for these (or any other) schemes of affordable home ownership. We would be grateful to hear from those who have experience of other forms of affordable housing to find out whether there may be difficulties in how these schemes operate within the commonhold model.

(3) Unsatisfactory security for mortgage lenders

- 2.44 The UK Finance Mortgage Lenders' Handbook (which provides guidance for conveyancers acting for mortgage lenders) indicates that around 70% of the institutions listed will not lend on a commonhold unit. Those that will not lend include major lenders such as Santander and the Royal Bank of Scotland.
- 2.45 We have been told that the reluctance to lend on commonhold may be partly due to a lack of certainty over what happens to lenders' security if the commonhold ends, for instance on insolvency. We would like to find out whether this is a concern in practice and whether there may be other reasons commonhold is unacceptable to most lenders.

⁸ Housing and Communities Agency, *Shared ownership and affordable homes programme 2016 to 2021 prospectus* (April 2016) p 4.

Question 5.

If you are involved in creating residential or mixed-use developments:

- (a) Have you previously considered using commonhold or would you consider using it for a new development?
- (b) Did (or would) commonhold offer sufficient flexibility to meet the needs of your development?
- (c) Were you (or would you be) affected by the incompatibility of commonhold with shared ownership?
- (d) What other factors influenced (or would influence) your decision whether or not to use commonhold?
- (e) What aspects of commonhold could be improved to make it more usable for new developments?

Please provide a description of the development in question, for instance the number of buildings in the development, the number of units within each building, and specifying the use of such units.

Question 6.

If you have experience with affordable housing schemes:

Do you foresee any issues within the current commonhold model which could make it difficult to incorporate forms of affordable housing other than shared ownership?

Question 7.

If you are a mortgage lender:

- (a) Do you currently lend on commonhold?
- (b) What influenced your decision to lend or not to lend on commonhold property?
- (c) What would make commonhold more satisfactory security?

Question 8.

Are you aware of any other issues which makes commonhold unsuitable or unattractive to any part of the property sector (for example, mortgage lenders, developers, commercial tenants, landlords)?

D WIDER ISSUES CREATING A BARRIER TO COMMONHOLD'S SUCCESS

- 2.46 In Government's response to its consultation on tackling unfair practices in the leasehold market, Government confirmed its intention to remove some of the financial incentives for developers to use leasehold: see paragraph 1.7 above.
- 2.47 Government will also be considering wider issues which could affect the success of commonhold, including a lack consumer awareness and difficulty obtaining finance. It is also possible that Government may consider introducing incentives for developers to use commonhold or compel its use in certain circumstances.
- 2.48 We invite views on these issues and will share consultees' responses with Government. Since these issues fall to Government, rather than the Law Commission, for consideration, we will report on consultees' views but will not make recommendations on them.

Question 9.

Government is considering wider issues which may affect the success of commonhold including:

- *financial incentives to prefer leasehold*
- *lack of consumer awareness*
- *difficulty obtaining finance*

(a) Do you think these issues may prevent the take up of commonhold?

(b) What other issues need to be addressed in order to reinvigorate commonhold?

(c) Should there be incentives to use commonhold (financial or otherwise), if so what should those incentives be?

(d) Should commonhold be compelled? If so, in what circumstances?

Chapter 3: General Questions

- 3.1 In addition to the specific questions we have asked about commonhold, there are a number of broader areas on which we would like to gather evidence.

Question 10.

If you have experience of both commonhold and leasehold:

How does your experience of commonhold compare to your experience of leasehold?

Question 11.

If you only have experience of commonhold:

How would you describe your experience?

Question 12.

If you only have experience of leasehold:

What advantages do you think commonhold could offer?