

Look out for leasehold loopholes

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The subject of the UK's 'housing crisis' is a firm favourite with the British press, and the media's current scrutiny of 'all matters housing' has recently thrown a fairly obscure property law, intended to protect homeowners, into the spotlight.

Ironically this law, the Landlord and Tenant Act 1987 (the [Act](#)), was originally introduced to protect homeowners from punitive service charges and unfair leasehold practices. However, it appears that a developer has recently used it to sell off freehold rights to investors, leaving the ultimate ownership of the tenants' freehold interests in the hands of potentially nameless investors. Thereby, the Act's poor drafting has opened a loophole, which allows developers to avoid provisions intended to give owner-tenants the chance to buy the freehold of their home.

Stepping into the tenants' Jimmy Choos, one could be forgiven for thinking this was unfair practice... couldn't one?

Since the turn of the last century, most homes in England and Wales were sold as freeholds, whereby a buyer would take ownership of the home itself and the land it was built on. Subsequently builders and landlords realised they could cash in on a new revenue stream, and so started selling houses and flats under leasehold agreements and separately selling the freeholds to investors.

As you may be aware, freeholds are considerable assets, because the owner can charge an annual ground rent to the homeowner. They also offer attractive annual yields of up to 10% of the purchase price.

Ground rents can cost the leasehold owner large amounts of money. According to recent research, the average

yearly charge now stands at £371 on new-builds and £327 on other properties (it can be a lot higher too).

When the government embarked on a [public consultation](#) to outlaw the sale of new-build leasehold houses in July, it cited (amongst others) the case of a family home which is unsellable because the ground rent will reach £10,000 a year by 2060.

It has been estimated that up to 100,000 homes in the UK are effectively unsellable because their owners will be forced to pay punishing ground rents. In many instances, the ground rents will increase exponentially as they are set to double every ten years.

According to government sources, there are 27 million homes in the UK of which 15% (some 4 million) are under leasehold arrangements.

The Act intended to give leaseholders of flats the "*right of first refusal*", which meant they were legally entitled to buy their freehold before the landlord sold it on to an investor. However, there are several problems with the Act:

1. the Act contains only provisions for leasehold owners of flats (i.e. not houses). This was understandable at the time because most houses were freehold properties. However, it is now common practice for builders to sell new-build leasehold houses. There are around 1.2 million leasehold houses in the UK. The government's recent consultation paper mentions the right of first refusal, but appears to rule out any extension of it to houses on the basis that it is (as seen) easily circumvented.
2. a clause in the Act makes exemptions for "associated companies." A common scenario is that a developer can register the freehold interests on a block of flats to an "associated company". Typically, a developer may

have a host of such associated companies on its books in readiness for such a plan. As long as the freehold company has been associated with the developer company for over two years, the developer can sell the shares (and therefore by extension, the freehold interests) in that associated company to an investor. The trick here is that the developers are not obliged to offer the owner-tenants a first option on the freehold's sale, because the developer is not directly selling the freehold, they are only selling the shares in the freehold company, thereby making it impossible for owners to buy their leaseholds as the law envisaged.

[Companies House](#) records show that at least two listed builders recently sold associated companies to ground rent funds.

This method of avoiding the law may have fallen out of favour with builders and landlords in light of another way to frustrate the Act's intention.

Developers now frequently enter into contracts with third parties, for example, regular ground rent investors, before any of the flats have been sold. This means that when the developer comes to complete the freehold sale to the third party, the Act does not apply pursuant to [section 4\(2\)\(i\)](#) because the developers are obliged to sell the freehold under a pre-existing contract.

A more recent law, the [Leasehold Reform Housing and Urban Development Act 1993](#) affords flat owners the right to purchase the freehold from an investor by means of "collective enfranchisement, but the process is subject to complex rules and requires a considerable feat of administration on the part of the tenants.

The process can involve significant legal and valuation costs with tenants paying the landlord's fees too. Further, it requires at least 50% of 'qualifying tenants' of a given building to agree to purchase the freehold.

The value of the freehold is often determined by negotiations between the parties' respective solicitors and valuers. If these negotiations fail, any dispute can be determined by a specialist tribunal.

It is interesting to note that in Scotland and Northern Ireland, a system exists by which the market value of the freehold is automatically determined as a multiple of the ground rent; however, there are no proposals to import this way of thinking into England and Wales.

In summary

Whilst the loopholes in the Act could easily be closed by removing some of the situations whereby certain disposals are not 'caught' under the Act, there does not appear to be any proposal to amend the Act itself so it is unlikely to be amended. Leaseholders of blocks of flats, in most cases, must therefore exercise their right to "collective enfranchisement" under the provisions of [Leasehold Reform Housing and Urban Development Act 1993](#),

Help is on its way!

Daniel Downes is a specialist in leasehold enfranchisement. If you have a query regarding the rights to your freehold interest, call him today.

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Note: This is not legal advice; it is intended to provide information of general interest about current legal issues.

