



Commonhold : The Third Option

Commonhold

The Problem with Leases

In England and Wales there has, since 1925, been only two ways to own land, freehold and leasehold. While freehold is close to absolute ownership leasehold confers upon the lessee the right to occupy a property for a fixed time period.

There are two principle problems with the leasehold system. First, the lease is a diminishing asset so as time progresses and the lease comes nearer to its expiry date the value of the leasehold interest tends to diminish. Successive Governments have sought to address this problem principally through the leasehold reform legislation starting with the Leasehold Reform Act 1967 which introduced the principle that long lessees of houses could compulsorily acquire their freehold. More recently, the Leasehold Reform Housing and Urban Development Act 1993 introduced a right for long lessees of flats to compulsorily acquire a fixed 90 lease extension. While these reforms have to some extent addressed the problem many people still feel unhappy with the concept that they only own something for a certain period of time.

Secondly, there is the problem of enforcement of covenants. One of the strengths of the leasehold system is that it provides a way of enforcing both restrictive and negative covenants contained in leases. This is something that cannot easily be achieved under the freehold system. While it is generally possible to impose restrictive covenants on freeholds there is no satisfactory method of imposing positive covenants.

Commonhold therefore seeks to address these two issues.

What is Commonhold?

Commonhold will be a third method of owning land that is neither freehold nor leasehold but contains some of the characteristics of both¹. It is not a new concept and has been in operation in other countries under different names (such as condominium or strata title) for many years. In this country the concept of commonhold has been discussed for many years but the Commonhold and Leasehold Reform Act 2002 means it is now a reality.

A commonhold will comprise a defined area of land that will include a number of "units" which might be houses, flats, shops or industrial units². The owners of each unit will be known as unit holders and will each be a member of the commonhold association³. The commonhold association will be a special form of company registered at Companies House and will be governed by a memorandum and articles of association in the usual way although the form of those documents will follow prescribed rules. A commonhold community

¹ Technically commonhold is not a new estate in land but is a type of freehold ownership.

² Sections 11-24 Commonhold and Leasehold Reform Act 2002.

³ Sections 34-36 *ibid*

statement will govern the property rights of the various unit holders and the association itself⁴. This statement must follow a prescribed form but will also to some extent be tailor-made to suit each commonhold. In many ways this document will resemble a lease and will set out each unit holders rights and obligations such as duties to pay service charges, to maintain their units and to comply with regulations for the mutual benefit of all unit holders. The statement will however be common to the whole commonhold, unlike leases, which relate to individual properties.

Unit holders of commonhold will have two interests in the commonhold: their own interest in the unit itself and their share in the commonhold association. It will not be possible to deal with one without at the same time dealing with the other.

Formation

Most types of property may be registered as commonhold but there are some exceptions such as agricultural property subject to an agricultural tenancy and land that lies above or below some other property which is not to form part of the same commonhold (i.e. "flying freeholds" will not be possible)⁵. Commonholds must therefore have clean vertical divisions from neighbouring properties.

The consent of 100% of those who have an interest in the land to be registered is required in order to create a commonhold⁶. This means that not only the freeholder but also the lessees and any other person who has an estate, interest, charge or has registered a caution over the land must give their consent. The Act does not contain any provisions permitting the owners of a block of flats to force a landlord to convert the property to commonhold. Once all the necessary consents have been obtained and the commonhold association has been set up at Companies House and the commonhold community statement has been drawn up application may be made to the Land Registry for registration of the commonhold. This will result in the closure of all freehold and leasehold titles and the issuing of new Land Registry titles to the unit holders⁷. The application must also be supported by a certificate given by the directors of the commonhold association confirming that all requirements have been dealt with. The Act recognises that registration might be effected in error and specifies that in those circumstances it is not the Chief Land Registrar who may rectify the mistake but instead it must be dealt with by the Court who are likely to try to rectify any mistakes made rather than undo the application⁸. Registration may be carried out either with unit holders already in existence⁹ or before unit holders go into occupation¹⁰. In the latter case transitional

⁴ Sections 31-33 *ibid*

⁵ Section 4 and Schedule 2 *ibid*

⁶ Section 3

⁷ Section 5

⁸ Section 6

⁹ Section 9

¹⁰ Section 7

provisions apply¹¹. This would, for example, permit a developer to set up a commonhold in advance of marketing the units.

Management

The management of the commonhold will be carried out according to the provisions of the memorandum and articles of association of the commonhold association and the commonhold community statement. It is important to note that each member of the commonhold may exercise one vote and there are no provisions in the Act (or in the regulations) permitting differentiation of voting rights. In addition various specific provisions apply in respect of the units and in respect of the common parts. One of the most significant of these is that there will be restrictions prescribed in regulations relating to the letting of residential units¹². It is likely the maximum permitted letting will be seven years. This is to avoid complicated lease structures arising with a series of leases and underleases. The letting of non-residential units will be governed by the same regulations and commonhold community statement. Unit holders may create charges over their units without consent but the consent of the commonhold association is required before creating any other interest over the unit¹³. Any attempt to do anything that goes beyond the powers permitted in the Act or the commonhold community statement will be void.

The Act provides the ability to change the size and extent of units and the common parts but in the case of the former the individual unit holder must consent in writing¹⁴. The association's right to transfer its interest in any part of the common parts may not be fettered in the commonhold community statement¹⁵.

The commonhold community statement is not necessarily set in stone and specifically it must include provisions about how it can be amended¹⁶. If it is amended the amended statement will take the place of the former statement and must be registered at the Land Registry.

Regulations are to be made making provision for the enforcement of the commonhold community statement and memorandum and articles of association of the commonhold association¹⁷. These may make provision for the enforcement of provisions both by the association against individual unit holders and by one unit holder against another with payment of compensation and reimbursement of costs if appropriate.

The commonhold community statement must make provision for an assessment of the annual income required to meet its expenses and must allocate those

¹¹ Section 8.

¹² Section 17-19 *ibid* Specific conditions (including the length of term) will be prescribed in regulations.

¹³ Sections 20-22 Consent requires 75% of all those who voted.

¹⁴ Section 23-24.

¹⁵ Section 27.

¹⁶ Section 33.

¹⁷ Section 37.

expenses between the unit holders with the percentages adding up to 100¹⁸. As for service charges, provisions will be included to permit the collection in advance of expenditure by regular payments of instalments and the statement may also contain provisions for the establishment of reserve funds¹⁹.

There will also be the ability for the association to be enlarged with the unanimous approval of its members²⁰.

Regulations will also provide that commonhold associations shall be members of an approved ombudsman scheme to handle disputes and complaints.

Termination

The Act outlines provisions for the winding up of commonhold associations although details are to be contained in regulations²¹. Commonhold associations may be wound up either voluntarily or by the Court. If at least 80% of the members approve application may be made to the Court for an Order permitting termination²² but this is not required if all 100% consent²³. A termination statement²⁴ must be prepared which sets out what will happen to the various interests of the unit holders and, if the Land Registrar is satisfied, he may then order a winding up and the conversion of the legal title to either freehold or leasehold or a combination of both. The termination statement will include provision for the appointment of a liquidator and in principle normal insolvency rules will apply so far as possible.

Where a commonhold association is insolvent a creditor may make application to the Court for the winding up of the association²⁵. The Act then envisages that the Court will wind up the association but provide for the creation of a new association to carry on its obligations so as to preserve the commonhold scheme²⁶.

Commentary

One of the most striking aspect of the Act is that commonholds can only be created with 100% support of all those with interests in the land affected. This means that the Act will not generally provide an alternative to collective enfranchisement and this is a disappointment to those who wish to accelerate the demise of the leasehold system. The requirement for unanimity in converting from freehold and leasehold to commonhold may, for practical purposes, make it virtually impossible to convert existing developments. The

¹⁸ Section 38.

¹⁹ Section 39.

²⁰ Section 41.

²¹ Sections 43-56.

²² Section 45.

²³ Section 44.

²⁴ Section 42.

²⁵ Under the procedures set out in the Insolvency Act 1986.

²⁶ Section 51.

requirement to set up a company governed by Companies House is likely to put off those in small developments such as houses divided into two flats where the expense is likely to outweigh the advantage. The proposals are also unlikely to be attractive to commercial landlords whose rights to let properties on leases of more than seven years might well be curtailed.

The proposals are therefore likely to be of greatest interest to those who are carrying out entirely new developments of either blocks of flats or houses sharing common facilities. A number of developers currently sell 999 year leases of newly built flats with a share of the company owning the freehold to be transferred upon completion of the development. The commonhold scheme should in effect be very similar in operation to such a scheme as this and therefore those developers are likely to find it of interest. One advantage from their point of view is that it will not be necessary to explain to potential purchasers (particularly those from overseas) why they are only acquiring a property for 999 years and not outright. Similarly developers of schemes which contain houses and also common parts such as private roads and sports facilities should find commonhold of interest as it provides a way of getting around the problem of enforcing positive covenants. Similar comments apply for sheltered accommodation and holiday complexes.

Commonhold is unlikely to be suitable for mixed residential and commercial development and developments where units differ greatly in size and value. The principal reason for this is because of the requirement that all members have the same voting rights. It is unlikely, for example, that the owner of a top floor penthouse flat (who pays a significant proportion of the overall service charge in the block) will accept that he has no greater voting rights than the owner of a one bedroom flat in the same building. There is no reason why commonhold should not apply to commercial property but in practice the restrictions on leasing and the conservative nature of the market means that in practice it is unlikely to be widely adopted.

The Act sets out a framework for commonhold but leaves many of the details to be determined by regulations, which will be enacted later by statutory instrument. These regulations contain much of interest to lawyers such as the precise details of what is to be contained in the commonhold community statement and the enforcement provisions. While it is therefore difficult at this stage to ascertain whether the scheme is likely to be successful there is little in the Bill that stands out as potentially disastrous. This is more than can be said for some recent Landlord and Tenant legislation. Undoubtedly there will be a period of uncertainty and there is therefore likely to be a slow take up of commonhold as developers may feel they do not wish to take a risk by being the first to use an untried form of title. If this is the case there are likely to be calls for commonhold to be made more accessible to existing developments and possibly an element of compulsion might eventually be introduced.

The part of the Commonhold and Leasehold Reform Act 2002 containing the commonhold provisions cannot be brought into force until the regulations have been published and, for technical reasons, the Land Registrations Act 2002 has been brought into force. The earliest date for the Land Registration Act 2002 is

Autumn 2003 and it is therefore unlikely that commonhold will be brought into force until January 2004 at the earliest.

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It should be noted that none of the legislation referred to in this paper is law and there is no guarantee that the Bill will be passed in the form it was introduced or indeed at all. The history of legislation in this field is that it has often been the subject of substantive amendment during its progress through Parliament. We would always therefore recommend caution in adopting any course of action solely in reliance on possible future changes in legislation