

These notes refer to the Commonhold and Leasehold Reform Act 2002 (c.15) which received Royal Assent on 1st May 2002

COMMONHOLD AND LEASEHOLD REFORM ACT 2002

EXPLANATORY NOTES

SUMMARY

3. The Act sets out to achieve the following ends:

Part 1 - Commonhold

- to define the nature of commonhold;
- to specify the registration process;
- to define the commonhold unit and the transactions which may take place, such as transfer, leasing etc.;
- to define the common parts of a development and to regulate their use, maintenance, transactions, such as charging etc.;
- to define the form and content of a commonhold community statement;
- to define the constitution and operation of the commonhold association;
- to deal with winding up of a commonhold association, both voluntarily and by the court;
- to make other miscellaneous and general provisions.

Part 2 - Leasehold Reform

- to give leaseholders a new no-fault right to manage their block of flats;
- to define the body corporate which will take over management, which will also be a private company limited by guarantee;
- to define the eligibility criteria (similar to the revised criteria for collective enfranchisement);
- to set out the procedures for exercising the right;
- to set out the functions and responsibilities of the managing body when the right is exercised;
- to provide safeguards for the landlord's continuing interest;
- to provide for what happens to pre-existing management contracts when the right is exercised;
- to provide dispute resolution procedures;

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- to provide for the termination of the right where the body fails to manage the building properly, or no longer wishes to exercise the right, or becomes insolvent;
- to make such other provisions as are necessary for the purposes of the right to manage;
- to amend the rules for collective enfranchisement under the Leasehold Reform, Housing and Urban Development Act 1993 ("the 1993 Act");
- to require that a body corporate (a company limited by guarantee with a prescribed constitution) be used to own the building;
- to simplify the eligibility criteria, e.g. abolishing the residence test and the requirement for at least two thirds of the leaseholders to participate;
- to amend the procedures for exercising the right;
- to give every qualifying leaseholder the right to join the company and thus participate in the enfranchisement;
- to clarify and simplify details of the valuation arrangements;
- to make consequential changes to the rules for the right to a new lease of a flat under the 1993 Act reflecting the changes to the rules for collective enfranchisement;
- to make consequential changes to the rules for the right of leaseholders of houses to buy the freehold or extend their lease under the Leasehold Reform Act 1967 ("the 1967 Act") reflecting the changes to the rules for flats;
- to give leaseholders who have extended their leases under the 1967 Act, the right to buy their freehold and to security of tenure at the end of the lease; and to change the procedures for buying the freehold of houses where the landlord cannot be found in line with the law in relation to flats;
- to strengthen the protection of leaseholders against the demanding of unfair charges;
- to extend the definition of service charge to include the cost of improvements;
- to simplify and strengthen the existing consultation requirements relating to service charges;
- to simplify and strengthen the existing requirements covering accounting for and safeguarding service charge monies;
- to introduce the right to challenge the reasonableness of one-off charges not recovered as service charges ('administration charges');
- to give leasehold valuation tribunals ("LVTs") jurisdiction to hear any dispute over liability to pay service charges and the reasonableness of the charge or the works or services involved;
- to extend the scope of the right to apply to a LVT for the appointment of a manager under Part 2 of the Landlord and Tenant Act 1987 ("the 1987 Act");
- to extend and clarify the grounds for applying for lease variations under Part 4 of the 1987 Act and to transfer jurisdiction to LVTs;
- to provide that action cannot be taken to forfeit a long lease for non-payment of ground rent unless that sum has first been demanded for the landlord; and

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that forfeiture action cannot be taken on any other ground unless the validity of that ground has first been established;

- to provide that forfeiture action cannot be taken for amounts which are less than a prescribed sum unless the amount or any part of it has been outstanding for a prescribed period; and a power to prescribe additional or different requirements to those already in existing legislation before forfeiture can be exercised in relation to breach of contract or condition in a long lease of an unmortgaged dwelling;
- to apply existing and new rights in respect of service charges, administration charges and protection against forfeiture to tenants of the Crown.
- to provide new rights for leaseholders of houses who are required by the terms of their lease to insure with an insurer nominated or approved by the landlord;
- to provide that charges levied by landlords under estate management schemes are to be subject to a test of reasonableness to be determined by the LVT;
- to consolidate and rationalise existing provisions governing the constitution and procedures of LVTs, and to amend them;
- to require permission for appeals against LVT determinations to the Lands Tribunal;
- to implement the recommendations of the Financial Management and Policy Review covering the work of the LVTs.

Part 1 - Commonhold

Background

Problem

4. In England and Wales, there are two ways to own land, freehold and leasehold. Each has its advantages and disadvantages in particular circumstances. Freehold comes closer to absolute ownership. Leasehold confers ownership for a temporary period, subject to terms and conditions contained in the contract, or lease.
5. A covenant is a promise contained in a deed, such as a deed passing ownership of property from one person to another. There are two types of covenant: the positive covenant, which is a promise to do something, such as to pay rent or to keep the property in repair, and the restrictive covenant, which is a promise not to do something, such as cause a nuisance to neighbours. For historical reasons, positive covenants cannot apply to freehold land once the first buyer of the property has sold it. However, both positive and restrictive covenants apply to leasehold property.
6. The problems with covenants are accentuated in the case of blocks of flats, where each flat will often depend on its neighbour for support and shelter, and the very stability of the building depends on the proper maintenance and repair both of the individual flats and the common parts. This means that, where it is desired to set up a scheme to allow for ownership of interdependent properties and for the management of the common parts and facilities, the scheme must, today, be based on leasehold ownership. There is no satisfactory scheme at present which would allow for freehold ownership in such circumstances.
7. As long term residential leasehold has become more and more widely criticised, pressure has grown for the Government to bring forward a scheme which would combine the security of freehold ownership with the management potential of positive covenants which could be made to apply to each owner of an interdependent property. That scheme is commonhold.

Brief outline of the proposed solution

The nature and creation of a commonhold development

8. Each separate property in the commonhold development will be called a unit. It might be a flat, or a house, a shop or a light industrial unit. The owner will be called a unit-holder. The body which will own and manage the common parts and facilities of the development will be called the commonhold association. The commonhold association will be a private company limited by guarantee, whose membership will be restricted to all the unit-holders within the development. The commonhold association will be registered at Companies House in the usual way and will have a standard set of memorandum and articles of association of the commonhold association which will be prescribed by the Lord Chancellor from time to time. This means that all the unit-holders in a development will have two interests in the property of the commonhold; a direct interest in the unit or units that they own and membership of the commonhold association which owns the common parts.
9. The commonhold association with its common parts and the associated units will be registered at HM Land Registry. In order to register, the developer of the commonhold development or the sponsor of a converting development will be required to present to HM Land Registry the memorandums and articles of association, and the commonhold community statement, which will contain the rules of the particular commonhold. There will need to be a degree of flexibility to allow for unique features of a particular development, for example to provide for the upkeep of a site of special scientific interest, or to make special arrangements for a sheltered housing component in the development. Allowance for this is to be made in the commonhold community statement where in addition to the prescribed matters, those relating to the individual attributes of the commonhold development can be set out. These discretionary elements will be registered and form part of the documentation maintained by HM Land Registry.
10. If it is necessary to obtain the consent of anyone with an interest in the land, those consents must be supplied at this stage and finally, a certificate will be required to confirm that the memorandum and articles of association and the commonhold community statement comply with the relevant Regulations. Once the required documents have been processed by HM Land Registry, the commonhold will be registered.
11. It will be possible for a unit to consist of two or more separate areas of land, for instance a flat with a garage in a detached block, or perhaps a shop with a separate storage unit. Units may be divided from each other vertically, as are terraced houses, horizontally, as are flats in a block, or may be free standing, as are detached houses or, often, light industrial units. However, where the divisions are horizontal, no part of the commonhold may be over any part of a building which is not part of the same or an associated commonhold development.

Conversion

12. It will be possible to convert from leasehold to commonhold but only if certain criteria are met. Details will be contained in Regulations, but it will be necessary to obtain the consent to conversion of 100% of the existing leaseholders and /or other owners of what would become units in the commonhold.
13. It is not intended that any scheme of conversion to commonhold should give rights to commercial leaseholders or rack rented commercial occupiers which would go beyond the scheme developed by the DTLR for collective leasehold enfranchisement. DTLR's scheme relating to qualifying buildings and tenants and rules relating to payments to existing landlords, where applicable, will be adopted so far as is possible, with the exception that to convert to commonhold will require 100% consents. Thus rules will be substantially the same for both types of conversion. Details will be contained in Regulations.

14. At the time of conversion all leasehold interests will cease to apply as will all terms of all leases and the units will be governed by the memorandum and articles of association and the commonhold community statement of the commonhold association.

Management of a commonhold development

15. It will be possible to add to and to diminish the size of the development by the purchase or sale of common parts provided that the specified majority of the members of the commonhold association is achieved at an appropriate meeting. There will be rules to govern the distribution of capital receipts arising from such a sale.
16. The voting rights of unit-holders in the commonhold association, the size of the various types of majority required for particular purposes, the minimum requirements for the maintenance of accounts and the machinery for the setting and for the payment of the commonhold assessment, which will be substantially similar to service charges, will all be set out in the standard memorandum and articles of association or the commonhold community statement.
17. The memorandum and articles of association or the commonhold community statement will set out the procedure for dealing with disputes arising within a commonhold. These are to be dealt with initially by use of internal procedures. Should these fail to settle matters, alternative dispute resolution (ADR) will be provided for. However, it is not intended to refuse access to the courts and tribunals as necessary. The Act will make provision for the making of Regulations which will provide for this.
18. The Act will make provision for the commonhold community statement to set out the rules governing rights of entry of the commonhold association for inspection and its right to carry out works and to recover costs of such works in cases of emergency or to facilitate its obligations to maintain and repair.

Winding up of a commonhold association

19. The detailed rules governing the winding up of a commonhold association will be contained in Regulations, though the scheme is set out substantially in the Act. The Regulations will require that the commonhold community statement sets out the rules governing the distribution of any profit arising on a voluntary winding up and other matters relating to the process. The winding up of an insolvent commonhold association will be carried out, so far as possible, under the standard insolvency rules. Any deviation from those Rules will be laid down in Regulations.

Part 2 - Leasehold Reform

Summary

19. **Part 2** of the Act makes reforms to residential leasehold law. These reforms will give leaseholders new rights and enhance their existing ones. They will help those leaseholders who will not be able, or who may not wish, to convert to commonhold.
20. A new right is established to enable leaseholders of flats to take over the management of their building without the need to prove shortcomings on the part of the landlord and without the need to pay compensation. The Act will make it easier for leaseholders of flats to buy collectively the freehold of their building by simplifying the eligibility criteria for exercising the right and reducing the prospect of costly disputes over the price payable. This will give all qualifying leaseholders the right to participate in such a purchase. Comparable changes are made to the right for individual leaseholders of flats to buy a new, longer lease and the right for leaseholders of houses to buy their freehold or extend their lease under the 1967 Act. Leaseholders of houses who have extended their leases under the 1967 Act will be given the right to buy their freehold and, if they do not, security of tenure when the extended lease expires.
21. This Part of the Act also provides greater protection for leaseholders against unreasonable service charges and other payments. It will enable leaseholders to resolve

a wider range of disputes before a LVT. It will strengthen the existing requirements for landlords to consult leaseholders about major works and extend them to cover any contract for works or services lasting more than 12 months. It will provide new rights for leaseholders of houses who are required to insure their property through an insurer nominated or approved by the landlord. It will simplify and strengthen the existing requirements for accounting and safeguarding service charge monies. It will provide that charges levied by landlords under estate management schemes are to be subject to a test of reasonableness to be determined by the LVT. It will extend the scope of the right to apply to a LVT for the appointment of a new manager and make it easier to vary defective leases. It will restrict the charging of penalties for late payment of ground rent and prevent the commencement of forfeiture proceedings until the facts have been determined. It will also prevent the commencement of forfeiture proceedings for amounts which are less than a prescribed sum unless the amount or any part of it has been outstanding for a prescribed period.

Background

22. There are currently around one million leaseholders of flats in England and Wales and a similar number of leaseholders of houses. It has long been recognised that the leasehold system of tenure has many drawbacks for long term residential occupiers. An investment in a home steadily loses value as the lease approaches the end of its term. Many leaseholders experience serious difficulties with their landlords, ranging from neglect of their obligations under the lease to outright exploitation. The system is virtually unique to England and Wales.
23. There have been a number of leasehold reform measures over the past 30 years or so which have attempted to remedy the worst defects of this form of tenure and give leaseholders redress against landlords' abuse of their position. However, the protection afforded by the law remains incomplete and the remedies available to leaseholders are unduly difficult and costly to use. The commonhold system introduced by Part 1 of the Act will provide a new form of tenure for properties containing several units, which is free from the drawbacks of the leasehold system. However, as explained in the notes to Part 1, many existing leaseholders are unlikely to be able to convert to commonhold and there is therefore a need to address the problems they face with the existing system.
24. In November 1998, the Government issued a consultation paper, 'Residential Leasehold Reform in England and Wales – A Consultation Paper', which invited views on the broad principles of a wide range of reforms. This paper attracted considerable public interest with over 900 organisations and individuals responding. A summary of the responses was published in December 1999¹.
25. In the light of responses received, the Government published detailed proposals for leasehold reform, along with those for Commonhold, in the form of a draft Bill and consultation paper on 21 August 2000². This also attracted considerable public interest with just under 1,100 organisations and individuals responding on leasehold issues.

Chapter 1: Right to manage

26. This Chapter introduces the new right for leaseholders of flats to manage their own building. It sets out the qualifying conditions for exercising the right and provides that eligible leaseholders must set up a qualifying company, known as a RTM company, in order to exercise it. It specifies on the face of the Act, and through a power to make regulations, the constitution of the company, including its memorandum and articles of association and entitlement to membership. It sets out procedures for exercising

1 ¹ An Analysis of Responses to 'Residential Leasehold Reform in England and Wales – A Consultation Paper' Final Report. Available from the Department for Transport, Local Government and the Regions, Free Literature, PO Box 236, Wetherby, West Yorkshire, LS23 7NB tel: 0870 1226 236 e-mail: detr@twoten.press.net

2 ² Commonhold and Leasehold Reform – Draft Bill and Consultation Paper: Cm 4843. Available free from The Stationery Office.

the right to manage and for the subsequent management of the building. It includes safeguards to protect the legitimate interests of the landlord and any other occupiers of the building (e.g. tenants on short residential leases and commercial occupiers). It also provides for the termination of the right if the leaseholders wish to do so, or if the RTM company fails to manage the building properly or becomes insolvent.

Chapter 2: Collective enfranchisement by tenants of flats

27. This Chapter amends the provisions of the 1993 Act dealing with the right of leaseholders to buy collectively the freehold of their building. It simplifies the eligibility criteria. In particular, it removes the requirements that at least two thirds of the leaseholders in the block must participate and that at least half of the participating group must have lived in their flats for the previous 12 months (or periods totalling three years in the last ten). It abolishes the low rent test in the few circumstances where this still applies (leases of less than 35 years). It also increases the proportion of the building that can be occupied for non-residential purposes from 10% to 25% and reduces the scope of the exemption for certain resident landlords.
28. At present, the 1993 Act provides for the freehold to be purchased on behalf of the leaseholders by a 'nominee purchaser' approved by them. It does not make any provision as to the nature or constitution of the nominee purchaser. This Chapter amends the 1993 Act so that the purchase of the freehold and subsequent management of the building is carried out by a 'RTE company' of which the participating leaseholders are members. The Act contains provisions relating to the constitution of the RTE company and a power to prescribe others by regulation. The constitution is similar to that of the RTM company for the purposes of the right to manage introduced by Chapter 1. All qualifying leaseholders will have the right to participate in the purchase by joining the company.
29. This Chapter also amends the valuation principles in the 1993 Act. It provides that where marriage value exists, it should be divided equally between the landlord and the leaseholders in all cases. It also provides that no marriage value is payable in respect of any lease held by a qualifying leaseholder if the unexpired term of the lease exceeds 80 years.

Chapter 3: New leases for tenants of flats

30. This Chapter amends the provisions of the 1993 Act covering the right of individual leaseholders to buy a new lease. Many of the changes reflect those introduced by Chapter 2. The low rent test is abolished. Where marriage value exists, it is to be divided equally between the landlord and leaseholder, and no marriage value is payable where the unexpired term of the existing lease exceeds 80 years. The existing requirement that the leaseholder must have lived in the flat for the last three years (or periods totalling three years in the last ten) is replaced by a requirement to have held the lease for at least two years. Where deceased leaseholders would have been eligible to buy a new lease immediately before they died, their personal representatives will qualify for a period of two years after the date of granting probate or letters of administration.

Chapter 4: Leasehold houses

31. This Chapter amends the provisions of the 1967 Act covering the right of leaseholders of houses to buy their freehold or extend their lease. The changes reflect those introduced by Chapters 2 and 3. The low rent test is abolished. Where marriage value would be payable, it is to be divided equally between the landlord and leaseholder, and no marriage value is payable where the unexpired term of the existing lease exceeds 80 years. The existing requirement that the leaseholder must have lived in the house for the last three years (or periods totalling three years in the last ten) is replaced by a requirement to have held the lease for at least two years, except in the case of certain business leases where the residence period is reduced to two years. Where deceased

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leaseholders would have been eligible to buy a new lease immediately before they died, their personal representatives will qualify for a period of two years after the date of granting probate or letters of administration.

32. This Chapter provides new rights for leaseholders who have extended their leases under the 1967 Act. They will be able to buy their freehold after the extended lease has commenced. The price will be determined in accordance with section 9(1A) of the 1967 Act. If they do not buy the freehold, they will become entitled to an assured tenancy under Part 1 of the Housing Act 1988 when their extended lease expires.
33. This Chapter also amends the 1967 Act to simplify the procedures for buying the freehold where the landlord cannot be found. It provides that leaseholders can apply to a county court (rather than the High Court) for a vesting order, and that a LVT will determine the price payable (rather than a surveyor appointed by the President of the Lands Tribunal). These procedures are the same as those applying for flats under the 1993 Act.

Chapter 5: Other provisions about leases

34. This Chapter makes a number of changes to provisions relating to leasehold management under the 1985 Act. It extends the definition of ‘service charge’ for the purposes of the 1985 Act to include any charge which is required to be paid under the terms of the lease to cover the costs of improvements. The effect of this change is that leaseholders’ existing rights in relation to service charges under the 1985 Act (e.g. a requirement of reasonableness and the right to challenge reasonableness at a LVT) are extended to cover improvements. It also includes a power further to extend the definition by secondary legislation.
35. This Chapter extends the jurisdiction of LVTs so that they can determine whether or not leaseholders are liable to pay service charges as well as the reasonableness of such charges.
36. This Chapter makes a number of changes to the existing requirements in the 1985 and 1987 Acts covering the accounting and safeguarding of service charge monies. Revised statements of account will make it easier for leaseholders to see where their money has gone. Service charge funds will have to be held in a separate designated trust account for each property or group of service charge payers. Leaseholders will have a new right to withhold payment of further service charges if key requirements are not met.
37. This Chapter introduces a new concept of ‘administration charge’ covering charges which are required to be paid under leases for approvals, for the provision of information, as a result of a failure to pay rent or other charges on time, or as a result of a breach of a covenant or condition of a lease. It sets out a requirement that administration charges must be reasonable. It enables leaseholders to challenge the liability to pay such charges, or their reasonableness, at a LVT. It also provides that charges levied by landlords under estate management schemes are to be subject to a test of reasonableness to be determined by the LVT.
38. This Chapter replaces the existing section 20 of the 1985 Act (which provides that landlords must consult leaseholders before carrying out works costing more than a prescribed sum which are recoverable through service charges) with a revised section. It requires landlords to consult before entering into agreements for the provision of works or services where the agreement will last for more than 12 months if the amount payable by any tenant through service charges exceeds an amount prescribed by regulations. If they fail to do so, they will be unable to recover any excess above that amount from leaseholders in relation to such a contract. It provides a power to make regulations exempting agreements of a prescribed description or in prescribed circumstances from this requirement. It also requires landlords to consult before carrying out works if the amount payable by any tenant through service charges exceeds an amount prescribed by regulations. If they fail to do so, they will be unable to recover any amount payable

by a leaseholder which exceeded the prescribed amount. It provides a power to make regulations specifying detailed consultation requirements. It also provides that a LVT may dispense with any of the requirements, if the tribunal is satisfied that the landlord acted reasonably. The landlord may also apply to a LVT for a dispensation of the requirement to consult before the works are carried out.

39. This Chapter extends the right to apply to a LVT for the appointment of a new manager under Part 2 of the 1987 Act to leaseholders where the lease provides that management is carried out by a third party rather than the landlord. It also restricts the scope of the exemption for resident landlords.
40. This Chapter extends and clarifies the grounds on which applications may be made to vary a lease under Part 4 of the 1987 Act. It also transfers jurisdiction for handling such applications from the county courts to LVTs.
41. This Chapter provides new rights for leaseholders of houses who are required to insure their property through an insurer nominated or approved by the landlord.
42. This Chapter introduces a new requirement that ground rent is not payable unless it has been demanded by giving the tenant a prescribed notice, and prevents the application of any provisions of a lease relating to late or non-payment (e.g. additional charges) if the rent is paid within 30 days of the demand being issued. It also introduces additional restrictions on the commencement of forfeiture proceedings for breaches of covenants or conditions of a lease. It modifies section 81 of the Housing Act 1996 to prohibit the commencement of forfeiture proceedings, including the issue of a notice under section 146 of the Law of Property Act 1925, in respect of non-payment of service charges or administration charges unless the charge has been agreed or admitted by the tenant, or a court or LVT has determined that it is reasonable and due. It also prohibits the commencement of forfeiture proceedings for other breaches unless a court or LVT has determined that a breach has occurred. There is also a new provision which would prohibit forfeiture proceedings unless the amount outstanding exceeded a prescribed sum or the amount, or any part of it, had been outstanding for more than a prescribed period. There is a power to prescribe the content of a notice which must accompany service and administration charge demands. Furthermore, there is a new power to prescribe additional or different requirements which must be met before the right of re-entry or forfeiture may be exercised.

Chapter 6: Leasehold valuation tribunals

43. This Chapter consolidates existing provisions covering the procedures and jurisdiction of LVTs and makes a number of changes. It provides that in all cases permission to appeal to the Lands Tribunal against a decision of a LVT must be sought; from the LVT in the first instance and, if they refuse, from the Lands Tribunal. It removes the requirement that at least one member of the tribunal shall be a qualified valuer. It provides a power to make regulations which would enable LVTs to exclude the whole or parts of cases of parties who fail to comply with directions and to award costs up to £500, or any higher amount which may be prescribed, against a party who has acted frivolously, vexatiously, abusively, disruptively or otherwise unreasonably. It further provides that where a case involves an appeal against a decision made by a LVT the Lands Tribunal cannot make an award of costs against a party to proceedings unless that party has acted frivolously, vexatiously, abusively, disruptively or otherwise unreasonably in relation to the appeal. The costs will be limited to £500 or such other amount as may be specified in regulations.

Chapter 7: General

44. This Chapter makes general provisions relating to application to Wales, procedures for making orders and regulations, and interpretation.