A guide to enfranchisement and lease extension

Flats and houses

GUIDE

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This guide is a general overview of the law as at 1 July 2019.

EdwinCoe LLP
LAW FIRM

1.0

Introduction

Leasehold Reform Act 1967

Leasehold Reform, Housing and Urban Development Act 1993

1.1 Introduction

The Leasehold Reform Act 1967 has now been with us for over 50 years.

The Act was originally intended to allow leaseholders of lower rateable value houses to acquire the freehold (this is known as "enfranchisement"). It has been amended significantly over the years to allow for more valuable houses to be enfranchised and by the removal of qualifying conditions.

The Leasehold Reform, Housing and Urban Development Act 1993 introduced for flat owners with qualifying leases, the collective right to enfranchise their block of flats and the individual right to a lease extension. It was also amended significantly by subsequent legislation.

The principal purpose behind the amending legislation was to make the enfranchisement process easier by reducing the qualification rules and simplifying the valuation process.

The Commonhold and Leasehold Reform Act 2002 attempted to make a collective claim fairer by giving all the tenants the opportunity to participate in a claim through the mechanism of a Right to Enfranchise (RTE) company. However, that particular set of amendments has never been brought into effect and, owing to the inadequacy of the drafting, is never likely to be.

2.0

The collective right to enfranchise

Leasehold Reform, Housing and Urban Development Act 1993

2.1 What is it?

This gives the right for tenants of flats acting together to purchase the freehold and any headleases of their building. In order for the building to qualify under the Act, it must:

- be an independent building or be a part of a building which is capable of independent development; and
- contain two or more flats held by qualifying tenants; and
- have at least two thirds of the flats held by qualifying tenants.

In order to be a qualifying tenant you must have a long lease which means a lease which, when originally granted, was for a term of more than 21 years. However, you must not own three or more flats in the building. You cannot be a qualifying tenant if you hold a business lease.

Notwithstanding the above, the building will not qualify if any of the following apply:

- it comprises four or less units and has a “resident freeholder”;
- more than 25% of the internal floor space (excluding common parts) is used for non-residential purposes;
- the building is part of an operational railway.

2.2 How do you prepare for a claim?

Any qualifying tenant can give a notice to his landlord or the managing agent requiring details of the various legal interests in the block. This notice places no commitment on the tenant but the response to the notice should provide the tenant with the information necessary for him to ascertain whether the building contains a sufficient number of qualifying tenants for it to qualify.

Having established that the building qualifies, it is then advisable to ascertain whether you have a sufficient number of tenants who want to participate, both for the purpose of qualifying for enfranchisement and for the purpose of being able to finance the acquisition. In order to qualify for enfranchisement, you need to establish that the number of participating tenants comprises not less than one half of all the flats in the building. However, if there are only two flats in the building then both must participate.

When you have established that the building qualifies and that there is a sufficient number of qualifying tenants who wish to participate, there are five further practical steps which should be taken before embarking on the enfranchisement process.

First, you should establish what it is going to cost by obtaining a valuation. In simple terms, the price to be paid by the participating tenants to purchase the freehold of the building is the aggregate of:

- the building's investment value to the freeholder; being the capitalised value of his ground rents and the value of his reversion (being the present freehold vacant possession value deferred for the unexpired terms of the leases);
- one half of the marriage value; being the increased value attributable to the freehold by virtue of the participating tenants being able to grant themselves extended leases at nil premium and at a peppercorn rent. The marriage value attributable to a lease held by a participating tenant will be deemed to be nil if that lease has an unexpired term of more than 80 years at the date that the initial notice is given;
- compensation for loss in value of other property owned by the freeholder, including development value consequent on the severance of the building from that other property.

The valuation date is the date of service of the claim notice. Value added to the flat of a participating tenant by tenant's improvements is disregarded in the valuation.

For the purpose of calculating the price, the tenants should take the advice of a properly qualified surveyor or valuer with experience in the field of enfranchisement and knowledge of the local market.

In addition to the price and the participating tenants' own legal costs and valuation fees, the tenants will be required to reimburse the freeholder his legal costs and valuation fees.

Secondly, the participators will need to establish how to finance the cost of the acquisition. It may, for example, be necessary for a number of participating tenants to seek mortgage funding. In particular, the participators will want to decide who is to finance the purchase of the non-participators' flats and on what basis.

Thirdly, it will be necessary to establish what vehicle the participating tenants should use in order to buy the freehold and how they will establish and regulate the relationship between themselves. In most cases, this is likely to be through a company structure, although in some circumstances a trust might be more appropriate. It should be noted that the participating tenants do not all have to have equal shares, so that the proportion of the shareholdings will be a matter for negotiation between them.

The 2002 Act provides for collective claims to be made through the mechanism of a Right to Enfranchise company. However, those provisions have never been brought into force and it is unlikely that they will be.

Fourthly, the participating tenants should seek advice to establish whether there are tax implications to the transaction, both in relation to their individual positions and in relation to the vehicle chosen to buy the freehold.

Finally, the collective enfranchisement legislation provides no guidance or controls on the way in which the participating tenants should work together in order to acquire the freehold. Since the purchase may well involve substantial sums of money, it is likely to take time to complete and, during this time, the participating tenants will be heavily reliant on each other for the performance of tasks within strict limits.

It is strongly advised that, before embarking on a claim, the participating tenants enter into a formal agreement (called a "participation agreement") in order to regulate the relationship between them during the course of the claim and to document how the purchase price and costs are to be shared between them.

2.3

How is the claim made?

It is important to be aware that most of the time limits imposed on the procedural stages of the claim are strict and a failure to do something within the required time frame can have dire consequences for the defaulter. It is essential that, by the time you reach the next stage of the process, you are well organised and supported by expert professional advice.

The reason for this is that the next procedural step is the service by the participating tenants on the landlord of what the Act calls the initial notice. This is the notice which claims the right to collective enfranchisement. Costs start to run against the tenants from the time that they serve the initial notice.

Amongst other things the notice must specify:

- the extent of the property to be acquired – supported by a plan;
- full particulars of all the qualifying tenants in the building – not just the participating tenants;

- the price being offered for the freehold – the offer does not need to be supported by a valuation but it should represent a genuine opening offer;
- the name and address of the nominee purchaser – the person or company nominated by the participating tenants to conduct the negotiations and to buy the freehold on their behalf;
- the date by which the freeholder must give his counter-notice, being a date not less than two months from the date of the service of the initial notice.

The freeholder is likely to respond with a procedural notice requiring the participating tenants to deduce title. The freeholder's valuer is also likely to inspect the building for the purpose of carrying out a valuation.

Within the period specified in the initial notice, the freeholder must serve his counter-notice. First and foremost, this must state whether or not the claim is admitted. If it is not, then the participating tenants must decide if they wish to dispute the rejection through the courts.

There are circumstances where the freeholder can resist a claim on the ground of redevelopment.

If the claim is admitted, then the counter-notice must state (amongst other things):

- which of the proposals contained in the initial notice are accepted;
- which of the proposals contained in the initial notice are not accepted and what are the freeholder's counter-proposals – particularly on price;
- whether the freeholder wants a leaseback on any units in the building not held by a qualifying tenant (for example, a flat subject to a short term tenancy or a commercial unit).

2.4 Disputes

If any terms of acquisition (including the price) remain in dispute after two months following the date of the counter-notice, then either party can apply to the First-tier Tribunal (Property Chamber) (or, if the property is in Wales, to the Leasehold Valuation Tribunal) for the matter in dispute to be determined.

This application must be made within six months following the date of the counter-notice or the claim will be deemed to have been withdrawn.

Most claims are settled by negotiation. However if a First-tier Tribunal is required to make a determination, then there is a right to appeal that decision to the Upper Tribunal (Lands Chamber) if permission is given to do so.

2.5 Completion

Once the terms of acquisition have been agreed or determined by the First-tier Tribunal, the matter reverts to a conveyancing transaction with the parties entering into a sale contract on the terms agreed or determined and then proceeding to completion.

If the matter proceeds to completion, then the participating tenants, through their nominee purchaser, will become the freeholder of the building, subject to the various flat leases. In effect, the participating tenants will replace the existing freeholder. This will put them in a position to grant themselves extended leases.

There may be tax consequences on granting an extended lease – particularly for second home owners.

There will also be responsibilities. The participating tenants will become responsible for the management of the building and the administration of the service charge account in accordance with the covenants in the original leases.

3.0

The individual right to extend

Leasehold Reform, Housing and Urban Development Act 1993

3.1 What is it?

The individual right to a statutory lease extension applies to all qualifying tenants of flats.

The qualifying condition is that you must be the tenant of a flat which you hold on a long lease (i.e. a lease granted for an original term of more than 21 years). Furthermore, you must have owned the lease for at least two years before the date of the claim.

For the purpose of the lease extension, there is no limit to the number of flats you may own in the building, and you may extend any or all of them provided that the conditions are met.

However, you cannot be a qualifying tenant if you hold a business lease.

The personal representatives of a deceased qualifying tenant can make a claim provided that the right is exercised within a period of two years from the date of grant of probate.

3.2

What do you get?

If you qualify, you will be entitled to acquire a new extended lease in substitution for your existing lease. This extended lease will be for a term expiring 90 years after the end of the existing lease and will reserve a peppercorn rent throughout the term.

Broadly, the lease will otherwise be on the same terms as the existing lease but the landlord will have certain additional redevelopment rights, exercisable within 12 months before the expiration of the current lease term and within five years before the expiration of the extended lease.

3.3 The price

The price (called "the premium") to be paid for the new lease will be the aggregate of:

- the amount by which the landlord's interest in the flat will be reduced consequent on the grant of the extended lease; being the capitalised value of the landlord's ground rent and the value of his reversion (being the present near-freehold vacant possession value deferred for the unexpired lease term);
- 50% of the marriage value (the additional value released in consequence of the tenant's ability to merge the extended lease with the existing lease). The marriage value will be deemed to be nil if the existing lease has an unexpired term of more than 80 years at the date of the claim; and
- compensation for loss in value of other property owned by the freeholder, including development value, consequent on the grant of the new lease.

The valuation date is the date of service of the claim notice.

In addition to the price and the tenant's own legal costs and valuation fees, the tenant will also be required to reimburse the freeholder for his legal costs and valuation fees.

3.4 How do you claim?

The procedure to be followed is very similar to that for collective enfranchisement. It is therefore important to be aware that most of the time limits imposed on the procedural stages of the claim are strict and a failure to do something within the required time frame can have dire consequences for the defaulter.

The qualifying tenant can serve a preliminary notice to obtain information. Thereafter, he serves his notice of claim (in this case called "the tenant's notice of claim") which amongst other things needs to state:

- a description of the flat – but not necessarily with a plan;
- sufficient particulars to establish that the lease qualifies;
- the premium being offered – the offer does not need to be supported by a valuation but it should represent a genuine opening offer;
- the terms of the new lease;
- the date by which the landlord must give the counter-notice, being a date not less than two months from the date of service of the tenant's notice.

The landlord is likely to respond with a procedural notice requiring payment of a deposit (equal to 10% of the premium being offered) and asking the tenant to deduce title. The landlord's valuer is also likely to inspect the flat for the purpose of carrying out a valuation.

Within the period specified in the tenant's notice, the landlord must serve his counter-notice. First and foremost, this must state whether or not the claim is admitted. If it is not, the tenant must decide if he wishes to dispute the rejection through the courts. However, unlike a collective enfranchisement claim where the nominee purchaser makes the application to the court in these circumstances, in the case of the statutory lease extension, it is the landlord who makes the application if he has refused the claim.

There are circumstances where the landlord can resist a claim on the ground of redevelopment.

If the claim is admitted, then the counter-notice must state (amongst other things):

- which of the proposals contained in the tenant's notice are accepted;
- which of the proposals contained in the tenant's notice are not accepted and the landlord's counter-proposals – particularly the premium.

3.5 Disputes

If either the terms of the lease or the premium remain in dispute after two months following the date of the counter-notice, then either party can apply for the First-tier tribunal (Property Chamber) (or, if the property is in Wales, to the Leasehold Valuation Tribunal) for the matter in dispute to be determined.

This application must be made within six months following the date of the counter-notice or the claim will be deemed to have been withdrawn.

Most claims are settled by negotiation. However, if a First-tier Tribunal is required to make a determination, then there is a right to appeal that decision to the Upper Tribunal (Lands Chamber) if permission is given to do so.

3.6 Completion

Once the terms of the lease and the premium have been agreed or determined by the First-tier Tribunal, the matter reverts to a conveyancing transaction with the parties proceeding to completion of the new lease.

You can withdraw at any time and there are provisions for your notice to be considered withdrawn if you do not meet certain strict time limits. As in collective enfranchisement, the tenant is at risk on costs from the date of his notice so it is essential to be prepared and to be properly advised before starting down the road to an extension.

A tenant's notice is capable of being transferred but only in conjunction with a contemporaneous sale of the lease. It is common for a seller to serve a notice and then transfer that notice with the lease to the buyer who will take over the claim.

There is no limit to the number of times that a tenant can exercise this right.

4.0

Enfranchisement of houses

Leasehold Reform Act 1967

4.1 What is the right?

The Leasehold Reform Act 1967 gives the tenant of a leasehold house who fulfils certain qualifying criteria the right to acquire the freehold and any intermediate leases.

4.2

How do you qualify?

In looking at the rules of qualification under the 1967 Act, there are three basic questions that need to be answered. First, does the building qualify? Secondly, does the lease qualify? Thirdly, does the tenant qualify?

In order for the building to qualify, it must be a "house". This has developed a wide definition which can include a shop with a flat above, or a building converted to flats. However, one essential feature is that there must be no material over or under-hang with an adjoining building (if there is then it is likely to be a flat).

The lease must comprise the whole of the house and it must be a long tenancy, (i.e. a lease granted for an original term of more than 21 years). However, if it is a business tenancy, it will not qualify if it is for an original term of 35 years or less.

The tenant must have owned the lease of the house for a period of at least two years before the date of the claim. At one time, it was also necessary for the tenant to occupy the house as his only or main residence for a specific period. The residence test has now been abolished save in limited circumstances.

If a house is in mixed use so that there is a business tenancy (for example a building comprising a shop with a flat above) or if the house includes a flat which is subject to a qualifying lease under the 1993 Act (see above), then the tenant is still required to fulfil a residence test. That requirement is that the tenant has to occupy the house (or some part of it) as his only or main residence for two years before the claim or periods amounting in aggregate to two years in the preceding ten years.

The personal representatives of a deceased qualifying tenant can make a claim provided that the right is exercised within a period of two years from the date of grant of probate.

4.3 The price

The 1967 Act has three different valuation methods. In every case, the valuation date is the date of the claim.

If the house qualified pre-1993 (i.e. by not needing to rely on amendments made to the financial limits and/or low rent conditions by either the 1993 Act or subsequent legislation) and had a rateable value of less than £1,000 (£500 outside the Greater London area) on 31 March 1990, the valuation is under section 9(1). This section expressly excludes any marriage value and restricts the valuation to a proportion of site value.

If the house qualified pre-1993 but did not have a rateable value of less than £1,000 (£500 outside the Greater London area) on 31 March 1990, the valuation is under section 9(1A).

The valuation elements are:

- the capitalised value of the landlord's ground rent and the value of his reversion (being the present freehold vacant possession value deferred for the unexpired lease term); and

- 50% of the marriage value (the additional value released by the tenant's ability to merge the freehold and leasehold interests). The marriage value will be deemed to be nil where the lease has an unexpired term of more than 80 years at the date of the claim.

If the house qualifies post-1993 (i.e. the claimant needs to rely on amendments made to the financial limits/low rent conditions by either the 1993 Act or subsequent legislation), the valuation is under section 9(1C). This is broadly the same as a section 9(1A) valuation except the freeholder can be compensated for loss in value of other property owned by him, including development value, consequent on the severance of the house from the other property.

4.4 How do you claim?

The procedure for a claim is relatively straightforward. The tenant serves his notice of claim, which is in prescribed form and needs to state (amongst other things):

- a description of the house – but not necessarily with a plan;
- particulars to establish that the lease and tenant qualify; and
- what the tenant thinks is the basis of valuation (unlike 1993 Act claims, he does not need to make an offer).

In addition to the price and the tenant's own legal costs and valuation fees, he will be required to reimburse the freeholder his legal costs and valuation fees.

The landlord is likely to respond with a procedural notice requiring payment of a deposit (equal to three times the rent payable under the lease), asking the tenant to deduce title and (if a residence test is relevant) to produce evidence by statutory declaration that he fulfils the residence condition.

The landlord's valuer is also likely to inspect the house for the purpose of carrying out a valuation.

4.5 Completion

Once the terms of the conveyance and the purchase price have been agreed or determined by the First-tier Tribunal, the matter reverts to a conveyancing transaction with the parties proceeding to completion.

You can withdraw at any time up to one month following the determination of the purchase price. Unlike collective enfranchisement and statutory lease extension claims, there are no strict procedural time limits. However, you will be liable for the landlord's costs from the date of your notice of claim.

A notice of tenant's claim is capable of being transferred but only in conjunction with a contemporaneous sale of the lease. It is common for a seller to serve a notice and then transfer that notice with the lease to the buyer who will take over the claim.

4.6 The extended lease option

The 1967 Act also allows the qualifying tenant of a house to take an extended lease of the house for a term of 50 years to expire after the term date of the existing lease without payment of a premium but at a ground rent that reflects the letting value of the site subject to the extended lease. This right has been little exercised in recent years not least because none of the amendments relating to the abolition of financial limits and the low rent test introduced by the 1993 Act or subsequent legislation apply to it. Furthermore, the extended lease originally had no statutory protection and carried no right to acquire the freehold.

However, all tenancies extended under the 1967 Act now have security of tenure. Furthermore, the tenant under an extended lease now has the right to acquire the freehold, if he otherwise fulfils the qualifying conditions.

In such cases, the purchase price will be determined in accordance with section 9(1C) but with modified assumptions.

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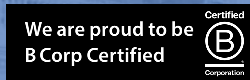

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