

Written evidence submitted by Izabela Patel to the Leasehold and Freehold Reform Bill Public Bill Committee (LFRB13)

Dear Sirs

Response to call for evidence in relation to Leasehold and Freehold Reform Bill

Background

I have 18 years' experience within the leasehold industry having been a leasehold flat owner, freehold house owner, an employee of a freehold investment company. I'd like to make the following comments;

Legal Agreements

Most property purchases are funded by way of mortgage. It is the lenders standard requirement that the buyers are represented by an approved solicitor or conveyancer. It is the legal representatives' obligation to ensure that the terms of the purchase are clear to the buyer: contract, transfer, lease terms, mortgage terms. It is therefore puzzling how so many leaseholders are not aware of, or don't understand the rights granted to them within the leases and the lease obligations they covenant to comply with when acquiring a leasehold property. Having said that ignorance or lack of understanding are not adequate grounds for the leasehold home owners to complain about the terms of the lease agreements they entered into (mainly with regards to the level of ground rent) and demand that those are disregarded and overwritten.

A lease is a legal agreement which has been approved by both parties and entered into in good faith after receiving legal advice therefore the terms within should not be overwritten by the new legislation. Removal of ground rent in existing lease contracts would undermine the sanctity of the UK contract law and would negatively impact on the lives of millions of people who would be faced with the unforeseen consequences of the proposal.

If the UK Government was to proceed with the proposed changes to existing lease agreements mortgage lenders might be reluctant to provide funding for property purchases, both freehold and leasehold, and refuse to provide re-mortgage terms to existing borrowers. Mortgage lenders may fear that the Government will next attempt to interfere with, and override the terms of other legal agreements, such as mortgage deeds. Most property purchases are funded by way of mortgage. If the leasehold property owners were to complain about unfair mortgage repayment rates, would the Government propose to overwrite the terms of existing mortgage deeds by amending the already agreed repayment rates or by completely removing the obligations on the borrower to make mortgage repayments to the lender? As absurd as it may sound, it follows the same principle as currently has been applied to the proposed changes to the existing lease agreements.

The Ground Rent Consultation and the Bill

The proposed changes to the existing legal agreements intend to abolish ground rent and in the consultation preamble the Secretary of State states that no compensation would be intended to be given to freeholders facing the loss of property rights/value/income. The consequences of such an action would provide freeholders and investors a legitimate cause of action against the government for expropriation of assets and a risk to the Treasury for claims running into the billions of pounds. The Impact Assessment assumes a cumulative loss to freeholders of over £27 billion before associated business impacts. This presents an ill-considered potential liability to the UK government and wider economy and would negatively affect the ability to provide services to the population. How would the Government propose to settle any such compensation claims? Would those be paid for from the tax paid by the general population bearing in mind that the beneficiaries of windfalls

would not be those in the lowest sectors of the economic spectrum, but property owners who may have benefited from property market price increases over time; as per the Impact Assessment 37% of leaseholders are buy to let investors /businesses themselves. This outcome would surely be counter to any sense of fairness.

While some of the provisions in the Bill reflect a reasonable need to improve protection for leaseholders, much of the proposed legislation represents a more fundamental attack on the contractual relationship between leaseholder and freeholder. The abolition of marriage value, the requirement for freeholders to take leasebacks under new enhanced leaseholder enfranchisement rights (thereby obliging freeholders to accept an unmarketable fragmented asset as partial consideration) and the changes to costs (which encourage argumentative leaseholders to dispute almost every freeholder action with impunity) will all work towards responsible freeholders questioning the sustainability of their business model. If the consultation on capping ground rents then also leads to a profound change in income rights from the most reliable and predictable of all income streams, with consequential impact on the freeholders ability to service debt, that will inevitably lead to many freeholders choosing, or being forced to leave the market.

The introduction to the consultation includes source material that misleads the public. The English Housing Survey (EHS) 2021-22 claims that the average annual ground rent was £298. This figure was derived from just 396 (out of 4.98 million) leases, of which 79 were from London. It is entirely likely that some of the London rents were far higher than usual due to the values of the properties being significantly more than the remainder of the country. Based on my experience within the industry leases created in the 1970's, 80's and 90's may have typical ground rents of £50-100 per annum. Leases created in the 2000's may have typical rents of up to £250 per annum with the effect of inflation and property value increases.

The Bill will require freeholders to meet their own legal costs in the course of leaseholder-initiated extension and enfranchisement activity. While there are rational arguments that these costs should be borne by leaseholders, as the process is a form of forced purchase, there is also a supportable rationale that the outcome creates value for both parties and that costs should be shared. My concern is that the proposals create an environment which could lead to freeholders incurring unnecessary costs where leaseholders do not act in good faith. In the absence in the proposed legislation of additional protection to expose irresponsible leaseholders to some reasonable risk of costs, it is likely the new legislation will lead to abuse.

Commonhold and Right to Manage

The Government has made continual reference to the promotion of Commonhold tenure as the desired default tenure. Commonhold has been introduced by the Commonhold and Leasehold Reform Act 2002 and despite existing for over 20 years it has not been popular with developers nor the leasehold home owners. It is mainly due to the complexity of establishing the structure, lenders refusing to accept commonhold properties as security for mortgages and the arguably better alternatives available such as leasehold. It is evident from DLUHC July 2023 research paper that majority of leaseholders do not welcome the prospect of being practically and legally forced to be responsible for management of buildings: 15. *“Most participants were not interested in personally playing an active part in the management of their building, for 3 main reasons: issues working with neighbours; a lack of time; and reluctance to take on additional responsibilities beyond those necessary as a homeowner (including building management and maintenance, as well as the legal responsibilities involved in collective ownership of the freehold);* 16. *Having the right skillset within the group of flat owners was considered the key factor in determining interest in taking on management responsibility. Some participants felt involving a management company would be their*

preferred approach to taking on additional management responsibilities. They lacked confidence that they would have the right skills, particularly when it came to legal knowledge or accounting. However, others felt that the costs incurred from hiring a director or appointing a management company may not work out to be cheaper than their current service charges, while some also felt that appointing a management company would involve ceding direct control over the building."

The Right to Manage has been available since 2002, however from my experience within the industry there has been very low interest from the leaseholders in taking up this option. Having been a leaseholder in a small block of flats I experienced lack of interest and willingness from other leaseholders to get involved in any maintenance, repair, service charge matters. Nowadays many flats are owned by investors who are not interested in undertaking management functions, nor arranging buildings insurance for the block. In addition, leaseholder populations vary over time so there is no ever-present continuity of resource. In contrast a freeholder provides a central point for continuity in the management and safety of the building. If legislative changes encourage or force freeholders from the market, leaseholders are likely to find themselves forced into much greater responsibility for their buildings regardless of how well equipped they are and their willingness to do so. This could leave huge numbers of leaseholders in a difficult position, unable to resolve issues previously assumed by the freeholder. For some the absence of a freeholder could be empowering for others - the old, the vulnerable, the time poor, the distracted, those people whose lives are already consumed with other things - it could prove disastrous.

The misconception of no service in return for ground rent

Ground Rent is for no service is a widely used phrase in written and oral government statements and while technically rent is simply the agreed contractual sum paid for the use of land and need not be justified for a specific use by the recipient, freeholders who receive such rents will accept that certain responsibilities travel with the benefit of the ownership and assume various functions and services that the rents fund. Examples of such functions are:

- Ultimate responsibility for building safety under the Building Safety Act 2022.
- Service charge loans where the service charge is insufficient to meet pressing requirements – the loans are often outstanding for long periods while S20 application process is undertaken and funding is required to stabilise a building problem.
- Financing of insurance premium payments when the premiums are due and sufficient funds have not been received from the lessees / no monies are available in the service charge fund.
- Dealing with enquiries from local authorities relating to planning matters, maintenance or adoption of existing roads and sewers which serve the wider estate / blocks of flats.
- Pursuing covenant compliance against non-covenant compliant leaseholders to ensure building safety and proper maintenance of the building.
- Pursuing covenant compliance against non-covenant compliant leaseholders to ensure other leaseholders have quiet enjoyment.
- A responsible freeholder provides a resourced and managed functional framework to ensure that all aspects of the lease obligations, building management, insurance and building safety are covered. In the absence of ground rent income or its significant reduction, there is a likelihood the freeholder will not have the financial capacity or commercial motivation to meet its other responsibilities.
- Assisting with disputes with neighbouring properties.

There are typically no provisions in the lease to enable freeholders to charge for most if not all these services. Some of them are irregular and often unpredictable. Importantly to provide these services they require the freeholder to have knowledge, time and funds to respond when required in a timely and proportionate way.

Implications of the proposed legislation:

- If ground rents were removed it would render many freeholders, who are reliant on rent for satisfying debt and for performing lessor's obligations, potentially unable to trade. The impact of non-functioning freeholder would see buildings management and oversight unable to be carried out leading to unsafe buildings remaining un-remediated, large scale disrepair, uninsured buildings, leaseholders stuck unable to buy or sell leasehold properties where no party exists to supply the required information, mortgage lenders unwilling to provide remortgage terms and fund purchases of leasehold properties.
- Fall in the value of leasehold properties, especially flats, in the event of the freeholder becoming insolvent due to loss of value of their freehold investment as this would result in unmanaged, uninsured blocks of flats in a poor state of repair, with no adherence to health and safety and fire risk obligations.
- Any cap would undermine the freeholder's financial ability to act responsibly in connection with a building which would have a negative impact on the mortgage lender's security.
- Any cap would undermine the income flow for investors including companies, pension funds, private individuals. In many cases it would destroy the value of the investment in which the pension fund, local authority or other investor has an interest. Indirectly this would also disadvantage any leaseholder with exposure to ground rents through their pension funds. Similar arguments could be made for council tax and rate payers where ground rent income forms part of the inflow of a local authority or other statutory body; less income flowing to these authorities from ground rents means higher recoveries are required from council tax and business rates payers.
- The trajectory of the government's proposed legislation and accompanying consultation prospectively remove all solid ground that underlies existing contract law. The adverse impact this could have on UK PLC as an investable jurisdiction for both UK and overseas businesses is immeasurable.
- Redundancies affecting employees of various freehold companies, managing agents, surveyors, conveyancers / solicitors. My job security along with the jobs of thousands of people working within the industry would be at risk as the result of the proposed changes. Will the Government consider reimbursing all those affected for the loss of income, which will be catastrophic for many during the current cost of living crisis?
- For leaseholders: increased costs for leaseholders incurred in resolving management issues due to absent freeholders; loss of value on unsalable homes; loss of rent if landlord leaseholders are unable to attract tenants to buildings that are unsafe or in disrepair; potential issues in obtaining mortgage or remortgage terms if lenders see property as a higher risk.

Summary

The consultation entitled "*Modern leasehold: restricting ground rent on existing leases*" runs parallel to the call for evidence - Leasehold and Freehold Reform Bill. The initial closing date for consultation has been extended from 21 December 2023 to 17 January 2024. The Committee is however planning to meet on 16 January 2024. As drafted, the provisions of the consultation and the draft Bill contradict each other in so far as the consultation invites responses to capping all existing ground rents, whereas the Bill currently includes provision to enable leaseholders an option for reduction in their ground rent to peppercorn but only for leases with terms of 150 years or more remaining. The extension of the consultation beyond the deadline for receiving evidence in connection with the Bill is a clear attempt to undermine parliamentary procedure as this denies the respondents the opportunity to comment on the full extent of the proposed Bill. This is because the Bill in its current draft will no doubt be subject to amendments which will be strongly influenced by the outcome of the ongoing consultation. This combination of contradictory content and inconsistent timelines,

along with little or no meaningful and balanced parliamentary debate during the Bill's first reading reinforces the absence of procedural safeguards to give respondents a reasonable opportunity to put their case cohesively to the authorities.

The proposed legislation and parallel consultation are centred on the basis that radical reform is needed to address perceived unfairness in the property marketplace and that the changes will significantly improve the lives of leaseholders. I believe this to be based on an ill-conceived and untrue view of the leasehold - freehold system and of the foundations based on which the system works.

The proposed changes would result in an expropriation of assets. Market compensation payable to the affected parties (freeholders and intermediate landlords, investors, pension funds) would be the only rational and reasonable remedy. In the absence of appropriate compensation, the UK Government would be open to numerous claims made by the freehold owners for breach of human rights through the ECHR. There seems to be a misconception that the freeholders are only large corporate companies, often based overseas, pension funds, insurance companies. It is worth remembering that freeholders are also private individuals who rely on the ground rent income for their livelihood, their pension, their children's life security. There is much irony in a government which encourages the working population to invest for their retirement but at the same time proposes to introduce legislation that would wipe out the value of numerous private freeholders' pensions. The only group that would benefit from any proposals would be leaseholders. The financial benefit to the leaseholders would however be a small gain when compared to all the negative implications on the lessees themselves, the freeholders and the wider market.

January 2024.