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FAO: The Chairs and Members
The Leasehold and Freehold Reform Bill Committee
House of Commons
London
SW1A 0AA

Our ref JKHO/EEMU

18 January 2024

Dear Committee

Call for Evidence- The Leasehold and Freehold Reform Bill ("the Bill")

CMS Cameron McKenna Nabarro Olswang LLP ("CMS")

1. INTRODUCTION

1.1 This response to the Call for Evidence from the House of Commons Public Bill Committee is submitted on behalf of CMS. We are an international law firm, with one of the largest real estate departments in the UK. We have over 800 lawyers specialising in property worldwide and we are ranked band one/tier one in the legal directories.

1.2 We have wide-ranging expertise in mixed-use and residential property issues, particularly leasehold and freehold enfranchisement. We have a dedicated and specialist enfranchisement team and act primarily for landlords who have a vast portfolio in freehold property, mainly which are based in Central London.

2. EXECUTIVE SUMMARY

2.1 We have excluded reference to comments on ground rent within this response, as we have separately submitted a response to the Government's Consultation on "Modern Leasehold: restricting ground rent for existing leases". We have attached this response in our email to you.

2.2 We are specialist Enfranchisement lawyers and not valuers, and accordingly we consider that the valuers are better placed to comment on valuation matters. Accordingly, we have not done so.

2.3 In summary, we have narrowed our response to the following key areas:

2.3.1 The ability to acquire common parts leases and the 'necessity test' (paragraph 3)

2.3.2 Mandatory leasebacks for non-qualifying flats (paragraph 4)

2.3.3 Cost recovery under Parts1 and 3 (paragraph 5)

2.3.4 Tenants who have already acquired their freehold (paragraph 6)

2.3.5 Change of non-residential limit on collective enfranchisement claims (paragraph 7)

2.3.6 Part 3 of the Bill: Further consequential amendments (paragraph 8)

2.3.7 Jurisdiction of Tribunals (paragraph 9)

2.4 This response is not intended to be a response on the entirety of the Bill and instead we focus on the areas that we consider require further thought.

3. THE ABILITY TO ACQUIRE COMMON PARTS LEASES AND THE 'NECESSITY TEST' (PARAGRAPH 3(3) OF NEW SCHEDULE A1)

3.1 Acquisition of common parts leases may be defeated at the sole discretion of the common parts lease owner (by granting permanent rights to enable the proper management and maintenance of the relevant parts - paragraph 3(4) of the new Schedule A1).

3.2 This appears to deprive leaseholders of rights of acquisition which they currently enjoy in the Leasehold Reform Housing and Urban Development Act 1993 (the "**1993 Act**").

3.3 We query if this change is intended to protect occupiers and owners of neighbouring buildings in an estate. However, we consider that the effect of this paragraph might be more wide reaching and suggest this is given further consideration.

3.4 We have specific concerns and suggestions on this point:

3.4.1 If rights are to be granted, these should be coupled with an obligation on the nominee purchaser's part to maintain on the terms and in the manner provided by the common parts lease – the common parts lease owner may owe obligations in this respect to others including non-participating tenants;

3.4.2 Should the ability to grant rights in lieu of an acquisition be limited to external common parts, or common parts shared with occupiers outside of the relevant building?;

3.4.3 We would suggest adjusting the burden such that it is for the common parts lease owner to show that it is reasonably necessary for it to retain the lease;

3.4.4 If a service charge is payable to the common parts lease owner in the relevant leases, should the rights be exclusive rights, to prevent the common parts lease owner levying service charges? It should be borne in mind that in certain structures the common parts lease owner is a party to the lease and there are often separate deeds of covenant;

3.4.5 Where non-participating tenants are required to contribute a service charge directly to the common parts lease owner, how is it intended that a nominee purchaser can recover the same where it has instead exercised rights to carry out the work?

3.5 Whilst we understand the reasoning for the provisions relating to acquisition of leasehold interests more generally, we do not consider that they will make enfranchisement "easier" for leaseholders. There should be clear statutory responsibilities for the provision of services and payment in respect of those services where leases are severed, particularly in respect of non-participating leaseholders and leaseholders situated elsewhere in an estate.

4. MANDATORY LEASEBACKS ON NON-QUALIFYING FLATS

4.1 It is plausible that under the current drafting, a freeholder of a mixed-use building who does not, as a matter of course, involve itself with residential premises, could become a direct landlord to a residential tenant. This position should be avoided.

4.2 This would work as follows:

4.2.1 Tenants require the freeholder to take a leaseback of a non-qualifying tenant's flat; and

4.2.2 The superior leaseholder requires, pursuant to s21(4) of the 1993 Act, that the nominee purchaser acquires its leasehold interest in the same flat.

4.3 We would suggest that Paragraph 7A(3) is amended to insert a new subsection (4) (with subsequent renumbering) in the following words:

4.3.1 "*a flat is leased to a non-qualifying tenant immediately before the appropriate time,*

4.3.2 *A lease of the flat that is superior to the lease held by the non-qualifying tenant exists at that time, and*

4.3.3 *the nominee purchaser has been required, in accordance with section 21(4), to acquire that superior lease*".

4.4 Caretaker flats should specifically be provided for:

4.4.1 Where a freeholder is required under the leases to house a caretaker, the flat allocated for that purpose should be exempted from a mandatory leaseback;

4.4.2 This will prevent issues already in existence in right to manage claims, whereby the RTM company is required to house a caretaker, but the freeholder retains control of the flat;

4.4.3 Alternatively, if leasebacks of caretaker flats are intended to be mandatory, both the nominee purchaser and the outgoing freeholder (who will be leaseholder) should be automatically released of any obligation in the leases to house a caretaker.

5. COSTS RECOVERY

Enfranchisement and Lease Extensions

5.1 Whilst we do not consider it is appropriate for a landlord to be unable to recover its costs in circumstances where it is forced to dispose of an asset, we comment as below.

5.2 Clause 12(2)(c) of the Bill should be amended to refer to "*any sums for which the tenant is liable under section 19C below"* rather than being omitted (with like amendments to sections 56(3) and 32(2) of the 1993 Act).

5.3 We appreciate that costs will be payable in fewer circumstances but consider it sensible for protection to be given to landlords in those cases.

5.4 New clause s89A(7) should be made clear as to who the former tenant is liable to. As drafted, this might permit a landlord to pursue a former tenant and we are not certain that this is the intention.

5.5 If however the intention is that the landlord can pursue a former tenant directly, provision should be made for the supply of information by the assignee as to the agreement in that respect upon assignment.

Service Charges / Administration Costs (Part 3)

5.6 We have significant concerns as to Clause 34.

5.7 Landlords will be faced with no choice but to apply to the Tribunal for an order permitting it to recover its litigation costs as a variable service charge and an order permitting it to recover the cost as an administration charge in all cases (where the leases allow). We fear that this will quickly overwhelm the Tribunal.

5.8 As a result of these applications, leaseholders are likely to incur costs in engaging representation.

5.9 As drafted, there is a significant imbalance between landlord and tenant which we consider needs further thought.

5.9.1 A landlord is only able to claim a service or administration charge relating to litigation costs where the lease permits it (s20CA(3)(a) of the 1985 Act and s5B(3)(a) of the 2002 Act) however a tenant is able to in all cases (s30J of the 1985 Act);

5.9.2 Additionally, that landlords expressly cannot recover their litigation costs in enfranchisement proceedings (reflective of the current position) and yet the tenant's implied term does not exclude this;

5.9.3 We do not understand why there is a differential between landlord and tenant in these circumstances (particularly where most leases do not permit recovery of costs relating to enfranchisement claims in any event and it is the landlord who suffers as a result of an enfranchisement claim).

5.9.4 Finally, the provisions providing that leases are of no effect where they are contrary to the relevant provisions do not appear to align with the drafting of the remaining provisions. For example, a Landlord can only recover costs where it would (apart from the relevant provision) be permitted to, however the clause in the lease permitting it to would be of no effect. We do not consider that is the intention in the drafting and it should be clarified.

5.9.5 If the amendment proposed to abolish forfeiture of residential leases is moved forward into the legislation, this would have the effect of nullifying most lease costs clauses

which expressly relate to s.146 Law of Property Act 1925. If there is no ability to forfeit, there can be no ability to recover costs. This should be considered where necessary.

5.10 Our preference is that the sanctity of the agreements is respected, however at the very least, landlords should be given an implied term which mirrors the term implied for the leaseholders' benefit.

6. ENFRANCHISING TENANTS WHO HAVE ALREADY ACQUIRED THEIR FREEHOLD

6.1 The current drafting of the Bill seeks to remove marriage value from the compensation calculation. We generally do not support this approach, however raise the following for specific consideration.

6.2 In prior claims, the leaseholders may have paid additional compensation for non-participating flats, including any (hope of) marriage value attributable to those flats. Those leaseholders will now be adversely affected by the current drafting of the Bill. Those who exercised their rights to enfranchise prior to the Bill will be unable to recover any of the value.

7. CHANGE OF NON-RESIDENTIAL LIMIT ON COLLECTIVE ENFRANCHISEMENT CLAIMS (CLAUSE 3 OF THE BILL)

7.1 Clause 3 of the Bill seeks to change the non-residential limit on collective enfranchisement claims to 50%. This will allow a large number of existing leaseholders to benefit from the right to enfranchise.

7.2 This amendment could be seen as going against Government's acknowledgement that it shall recognise the legitimate interests of existing landlords. Enfranchisement is, on a very basic level, a property right aimed at giving those in residential homes the right to acquire their freehold. The increase in percentage to 50% goes far beyond this.

7.3 Landlords have been developing buildings with the 25% threshold in mind when doing so. The extension of enfranchisement rights by way of the threshold increase will no doubt affect countless portfolios to the detriment of the landlord, who would have developed on the basis that the building would not qualify for enfranchisement.

7.4 Careful consideration should be given to increasing this threshold. It could devalue landlord's assets further if enfranchisement rights are exercised and (when such claims complete) subsequently the management of the building falls below the required standard. Commercial tenants could be deterred by inadequate management, which would subsequently have an impact on the market rent the Landlord is able to charge.

8. PART 3 OF THE BILL: FURTHER CONSEQUENTIAL AMENDMENTS

8.1 We consider that the amendment to section 18 of the Landlord and Tenant Act 1985, specifically an introduction of the concept of a "variable service charge" requires additional consequential amendments or further provisions.

Landlord and Tenant Act 1987 (the "1987 Act")

8.2 We consider that the following sections should be amended to refer to a "variable service charge" in place of a "service charge":

8.2.1 Section 23(2A)

8.2.2 Section 24(2)(ab)

8.2.3 Section 35(2)(f)

8.2.4 Section 35(3A)

8.2.5 Section 35(4)

8.2.6 Section 35(6)

8.3 The above sections directly relate to the reasonableness and proportions of service charges which will only be relevant to variable service charges.

8.4 Where charges are fixed, this represents an agreement reached between landlord and tenant with a shared risk:- there will be cases where a tenant is paying more than the cost of services, but also where a landlord is recovering less than the cost of services.

8.5 It does not appear to be the intention that in such cases a party could apply to appoint a manager or to vary the lease (noting, for example, that a fixed service charge will not be subject to a test of reasonableness under the Bill).

8.6 If however we are mistaken as to our view of the intention it should be clarified:

8.6.1 How a fixed charge will be considered to be "unreasonable" for the purposes of Part II of the 1987 Act where the s.19(1) 1985 Act test of reasonableness does not apply; and

8.6.2 Whether s35(2)(e) of the 1987 Act, including s35(3A), will enable landlords and tenants to effectively convert a fixed charge into a variable charge.

8.7 Without clarification we would expect that the Tribunal will quickly become overwhelmed with applications from landlords who have been unable to recover excess costs as a result of fixed charges. Tenants may also seek to apply where the fixed charge is no longer advantageous to them.

8.8 We recognise that it would be beneficial for service charges to be held in trust (sections 42 and 42A of the 1987 Act) regardless of whether they are fixed, however this removes any potential benefit to the landlord of a fixed service charge including the ability to utilise any excess to cover shortfalls in subsequent years.

8.9 A balanced solution would be to require that fixed service charges are held in trust until the end of the particular service charge year, once relevant costs have been defrayed and accounted for. Failing that, we consider the references in the relevant sections to "service charge" should be to a "variable service charge".

Amendments to The Commonhold and Leasehold Reform Act 2002

8.10 Section 94 – Our position here aligns with that as to sections 42 and 42A of the 1987 Act. Uncommitted service charges from the current service charge year (and not before that) would be more appropriate in the case of fixed service charges.

8.11 Section 103 – Whilst we consider it implicit that the service charges referred to in s.103 will be variable, for consistency and ease of understanding we query whether it would be sensible to express this as a variable service charge.

Amendments to the Housing Act 1996

8.12 Section 81 - we consider this should be amended to refer to a "variable service charge" (with fixed service charges being subject to s.168 Commonhold and Leasehold Reform Act 2002), since issues of reasonableness and payability will not arise.

8.13 Section 84 – we cannot see any benefit in this section applying to fixed service charges and it will cause a detriment to landlords in terms of administration time, along with wasted time, effort and cost on the part of the recognised tenants' association.

Amendments to the Building Safety Act 2022 (the "BSA")

8.14 We consider that Schedule 8 of the BSA should be amended to refer to a "variable service charge" in place of "service charge". In a fixed service charge, there is no ability to isolate costs and this could result in landlords being unable to recover a service charge at all (though it is acknowledged that a fixed service charge on a high-rise would be unusual).

9. JURISDICTION OF TRIBUNALS

9.1 We have commented above as to our fear that Tribunals may become overwhelmed (paragraphs 5.7 and 8.7).

9.2 In the London first-tier Tribunal (where most of our cases are heard) parties benefit from efficient case management and quick progression of enfranchisement cases.

9.3 We have experienced some variance in the regions, however generally processes are slick and cases advance relatively quickly.

9.4 This is a real benefit to leaseholders. In many cases, lease extension claims are made to enable a leaseholder to sell their property and speed is therefore of paramount importance.

9.5 Quicker processing also facilitates settlement, where neither party wishes to incur the costs associated with a hearing.

9.6 Whilst we support the Tribunal gaining more jurisdiction to deal with these claims (which we consider benefits leaseholders and allows for appropriate use of the specialist Judges) the infrastructure must be improved where necessary to deal with the potential for overwhelm and allow for cases to continue being dealt with efficiently.

If there are any questions in relation to this response, please contact Jake Holmes in the first instance, whose contact details are shown at the top of this response.

Yours faithfully

CMS Cameron McKenna Nabarro Olswang LLP