

Chapter 24

Question 1: Why is it difficult to achieve freehold ownership of flats?

The legal challenge facing a successful ownership structure for flats is to provide a mechanism whereby positive, as well as negative, duties can successfully be imposed upon the flat owners.

Flats are interdependent. Whilst a flat owner will require exclusive possession of their flat, they will also require rights over both the other flats within the block and over the common parts of the development. Easements, being rights over the land of another, can serve this purpose. In addition there needs to be a mechanism by which the block as a whole, including the individual flats and the common parts, is maintained and kept in repair. Covenants, as agreements binding on the flat owners, can serve this function but only if positive, as well as negative. Positive leasehold, but not freehold, covenants are enforceable between successive flat owners and thus the leasehold structure has evolved.

This problem is explained in section 24.1.

Question 2: How successful do you think the long leasehold system of flat ownership has been?

The problem outlined in question 1 has been addressed in this country by employing the long lease in which positive leasehold covenants are enforceable between those bound by privity of estate. A flat owner is granted a long lease of their flat by the developer in which the flat owner is granted exclusive possession of their flat and easements of support from the flat below and protection from the flat above as well as rights to use the common parts, services and facilities. The lease will also contain negative covenants to be performed by the flat-owner to govern their use of their flat and positive covenants to pay the ground rent and service charge as well as for the flat owner to keep in repair the interior of their flat. The obligation to repair the structure and common parts is imposed upon the landlord through covenants given by the landlord in the lease and funded by flat owners through the payment of their service charge.

The weaknesses of this long leasehold system and the steps that have been taken to address these weaknesses are explored in sections 23.2 and 23.3. They revolve around the limited duration of the long leasehold term and the risk that the term may be brought to a premature end by forfeiture, problems of the repair and maintenance of flat developments and excessive levels of service charge, the difficulty of varying the lease where the terms are defective and the general difficulties of communal living. These problems are generally less acute where the freehold of the block is transferred by the developer to a management company which is collectively owned by the flat owners. The flat owners are then the masters of their own fate so that, provided they are able to work together, they can overcome these issues.

Where this is not the case and the freehold continues to be held by the developer or another party as an investment, a conflict of interest can arise. Piecemeal legislative reform has sought to address the problems outlined. For instance, the flat owners have been granted rights to extend their leasehold term or to collectively acquire the freehold through a process known as enfranchisement, whilst forfeiture of residential long leases is more strictly controlled than where the lease is of commercial premises. Poor management problems have been addressed by granting flat owners a right to take over the management of their block, to question the levels of service charge and to call for the variation of their leases where the problem arises from a defective lease. However, these remedial measures are complex and cannot address the fundamental challenges of communal living.

Commonhold has been enacted to provide an alternative to the flat ownership regime but it too faces similar challenges. It has unfortunately not proved popular, particularly with developers and lenders, but the Law Commission is proposing to reinvigorate commonhold as the preeminent, and perhaps even the sole tenure, for

the ownership of flats and other multi-unit developments. In doing so this country would follow the lead other common law jurisdictions. A summary of the Law Commission's recommendations is set out in section 23.3.5.

Question 3: What are the current deficiencies in commonhold, as it has been enacted under the Commonhold and Leasehold Reform Act 2002? Are these deficiencies solved by the Law Commission's recommendations for reform of commonhold?

The way in which commonhold operates is explained in section 23.4. The main features are that instead of a lease a commonhold owner will obtain a freehold title, rather than a long lease, which is subject to the provisions of the Commonhold Community Statement which sets out the reciprocal rights and duties necessary for the regulation, maintenance and management of the development. The development itself will be managed through a collective body in which all the flat owners are members called the Commonhold Association.

We point out the main deficiencies of commonhold in sections 23.3 and the first extract in section 23.5.

The initial promise of commonhold as a more effective successor to the long leasehold system of flat ownership has failed to materialise, with very few developments choosing to adopt the commonhold structure. The reason for this lies not only in a natural conservatism to stay with a tried and tested system, but in a number of perceived deficiencies of commonhold which has led financiers, and thus developers, to be less than enthusiastic about embracing commonhold.

First, commonhold is only a realistic option for new developments as it is difficult to convert an existing long leasehold development to commonhold. Secondly, commonhold and leasehold do not mix. Thus whilst a commonhold may sell or mortgage their flat they are not free to let it for more than a seven year term and to deal with part only of their flat. These restrictions reflect the purity of commonhold but also limit its attraction to investors in the buy to let market. Thirdly the balance of power between the commonhold association and the flat owners has drawn criticism. The association's power to dispose of the common parts and to fix the level of service charge without the consent of the flat owners provide examples of powers that may be too favourable to the association. On the other hand, the association's limited powers to recover unpaid management charges from the flat owners is a serious handicap. Fourthly, it was originally envisaged that the commonhold community association would be a tailor-made corporate body designed to suit its purpose. However, that has not been the result. Instead, the legislation has adapted an existing corporate structure, namely the company limited by guarantee, which rather falls short of the envisaged ideal. The rule of the majority which underlies the governance of companies is not felt to be suited to communal living arrangements and the requirement that all units should be entitled to equality of voting, regardless of their respective size or value, is considered too inflexible. Last, but by no means least, real concern also surrounds the position of the association in the event of its insolvency which might be precipitated, or at least aggravated, by its limited powers to recover unpaid management charges.

The Law Commission's key recommendations for reform are considered in section 23.5 and are set out in second extract in that section. These recommendations are intended to address the deficiencies in the law just outlined. First, the need for unanimity to convert to commonhold is to be removed with a more efficient and simpler system of conversion to commonhold recommended. Secondly, they recommend making commonhold a more 'flexible' structure to cater for a wider range of developments for example those with mixed commercial and residential use and to enable shared ownership and Islamic complaint finance. Thirdly, they recommended various reforms to address the financial viability, stability and accountability of commonhold developments for example to ensure there are reserves to cover future repairs, robust measures to recover of service charges from residents and to ensure that lender's interests are sufficiently safeguarded. Lastly, recommendations are made that are intended to address the danger of the tyranny of the majority by trying to ensure that flat owners know their rights and obligations and have a clear route to resolve their differences initially through a bespoke commonhold dispute resolution process but ultimately by resort to the First Tier Tribunal.

Question 4: Beyond law reform, what further steps are necessary for commonhold to become more widespread?

Reforming the legal structure for the ownership of flats is only part of the story. It is also important that the revised tenure is embraced by all 'the players' in the development of flats including developers, their financiers, the legal profession and, of course, prospective flat owners. This requires a change in attitude which may even need to be 'forced' by the mandatory adoption of commonhold. The Law Commission recognise this need in the extracts from their reports found in sections 24.5 and 24.6.

It must also be recognised that close communal living presents challenges that the law is only partly able to address. There are inevitable social factors, economic challenges and power imbalances that need to be addressed and reconciled. The experience of other jurisdictions is that structures similar to commonhold can only go so far. Nevertheless, a bespoke coherent legal structure undoubtedly is supportive.