
SERVICES TO LEASEHOLDERS
UNDER THE LEASEHOLD REFORM ACTS

BUYING THE FREEHOLD OF A BLOCK OF FLATS

Freehold and Leasehold

House ownership in England is usually on a freehold basis. It is the property itself, ie the bricks and mortar and the garden, that is owned. Freehold ownership effectively means outright ownership forever.

Flat ownership is different because every flat owner relies on at least one other owner for support, so needs that owner to maintain their property properly. The problem with freehold ownership for flat owners is that positive covenants in freehold titles are only enforceable against the original purchaser. So virtually all flats in England are held leasehold, even if "with a share of the freehold", to enable the other owners to be forced to do something if necessary.

However with a leasehold, the owner does not own the 'bricks and mortar' but only a right to live in the property for the unexpired term of the lease. At the end of that time, the owner has no further rights and ownership of the property passes back to the landlord.

Usually a ground rent is payable under the lease and, in some cases, the lease provides for the ground rent to rise periodically. Sometimes the increase is to a fixed amount, but occasionally the new rent is to be calculated on a formula set out in the lease which leads to a very large increase, much larger than general inflation would suggest and occasionally even larger than the general rise in property prices.

One problem that besets all leaseholders is that, although they may have paid good money for the lease and have had no difficulty in raising a mortgage, once the remaining term drops below 60 years or so it may become very difficult to re-mortgage in the usual way.

Rights to Buy

To combat the problems of leasehold ownership, the Leasehold Reform Act of 1993 gave lessees of flats a right to buy the freehold of their block of flats. Companies, persons living abroad and people with second homes can participate in buying the freehold of their block.

The Leasehold Reform Acts give residential lease owners a right of compulsory purchase. That's a powerful right. Outside leasehold reform, it can only be exercised where companies or individuals cannot be allowed to obstruct the development of major schemes being created for the public good. The right puts lessees, who are mostly private individuals, in the same position as public and statutory bodies - the only ones which can exercise the general right of compulsory purchase.

The Price and the Opportunity for Financial Gain

The aim of all compulsory purchase legislation, including the Leasehold Reform Acts, is to ensure that those from whom property is being taken against their will, are properly compensated. In essence, the Leasehold Reform acts say that the landlord who has to sell the whole or part of his interest, is to be paid the value of that interest as if it were being sold to another investor and, except where the lease is very long, 50% of the marriage value. The 50% retained will be partly eaten up by the professional costs of the claim. Anything left over is only a paper profit, but it becomes cash when the flat is sold.

Leaseholders who are either paying a high ground rent or who face a large rent review, have additional benefits. For a lump sum they can convert the rent payable throughout the lease to a lump sum. That can be covered by a mortgage which, in normal times, is usually at a beneficial rate of interest as compared to general interest rates and for a fixed term which is often shorter than the lease. Further a high ground rent depresses the value of the lease. Without the rent, there is an increase in the value of the flat and it is then that higher value that grows with the general increase in house prices.

Who Has Rights

There are tests to define a 'block' of flats - basically it must stand on the ground and be capable of independent redevelopment. Potentially touching buildings can group together to form a block of flats. Not more than 25% of the internal floor space of the block can be used for non-residential purposes.

At least brds of the flats must have been let for a period longer than 21 years, but it does not matter how many years are left on the leases. The rents are irrelevant. These are known as 'qualifying tenancies'. There is no minimum period of ownership.

The 'qualifying tenants' have the right to participate in buying the freehold of a block and at least 50% of them must participate in the claim by signing the claim form. The personal representatives

of a lessee who qualified before death, can participate up to 2 years after the death. The participants operate through a "Nominee Purchaser" which is usually a company owned by those participants who contribute to the costs. It is the Nominee Purchaser which buys the freehold.

The Process

The first step is to send a formal claim to the landlord. The claim obliges the participants to meet certain costs incurred by the landlord as a result (see below). A financial offer must be made for all the interests to be acquired. After about 2 months the landlord must accept or deny the lessees' right to buy and say which parts of the offer are acceptable. Counter-offers must be made for those which are not acceptable.

There is then a period during which negotiations take place to see if the terms of purchase can be agreed. Disputes are resolved by an independent First Tier Tribunal (FTT). An application must be made to the local FTT to determine the terms of purchase, otherwise the claim will be deemed to have been withdrawn 6 months after the date of the counter-notice. Modest fees are payable to the FTT.

Once the terms have been agreed or determined by the FTT, the legal process continues. There are more statutory timescales at this stage but, broadly, the period from the agreement of all the terms of purchase to completion is about 2 to 4 months. The whole process rarely takes less than 12 months and can last longer. A claim can be withdrawn at any time before completion, but the landlord's costs have to be paid and no further claim can be made during the next 12 months.

After the Nominee Purchaser has bought the freehold, the flat leases stay in place. The Nominee Purchaser and each lessee can agree that a new lease should be granted; generally those lessees who contribute to the costs only do so in return for the promise of being granted a new 999 year lease.

The Valuation

The price is calculated at the date the claim is made. The 'building blocks' of the calculations are the values of:

- the lessees' leases currently and after the claim

- the rents payable by the lessees
- the landlord's right to repossess the flats at the end of the leases
- the hope that non-participants will want to extend their leases in the future
- any potential to develop the block or the grounds in the future
- marriage value in the participants' flats

'Marriage value' is released or created when the claim completes because it is only the tenant who can marry up the leasehold with the freehold. Normally 50% of the marriage value is payable. However, if a participant's lease has more than 80 years unexpired when the claim is made, no marriage value is payable because, in practice, the marriage value will only be a small amount and will probably be eaten up by the costs.

Because the values are assessed at the date of the claim, any rise or fall in the market during the process period, is irrelevant.

The value of improvements made by tenants is ignored so that the tenant does not 'pay for the improvements twice'. The cost of the improvements is not relevant, either when they were actually carried out or, if they were to be carried out again. The discount is the value that the improvements add at the date of claim. Improvements carried out many years ago probably require 're-improving', so may add no value. However space added almost always adds value, although the opportunity to add the space is part of the 'unimproved' value.

The Professional Costs

The Nominee Purchaser will incur legal costs in making the claim and taking all the necessary steps to make the claim safe, keeping it 'alive', in agreeing the form of transfer and in taking valuation advice. As soon as a claim is made, the Nominee Purchaser is also responsible for the landlord's reasonable costs in dealing with the claim, whether the claim completes or is withdrawn. Those costs are the landlord's valuation and legal costs, but not the costs he incurs in negotiation or going to an FTT to resolve a dispute. The FTT determines the recoverable costs if they cannot be agreed.