

Buying the Freehold Interest in your Building with other flat-owners

29 JANUARY 2020

CATEGORY:
ARTICLE



This note sets out the procedure following the changes introduced by the Commonhold and Leasehold Reform Act 2002.

Is collective enfranchisement possible?

As a preliminary, you need to know whether you and your fellow flat-owners qualify so as to be able to act together to collectively enfranchise your block, i.e. to go ahead with a collective claim for the freehold.

First, you need to check whether the building qualifies. If it is to qualify:

- it must be 'self-contained'
- no more than 25% of the building may be in non-residential use
- it must contain two or more flats owned by 'qualifying tenants' (see below)
- at least two thirds of the total number of flats in the building must be held by 'qualifying tenants'

It should be noted that if there is a 'resident landlord' in the building, it may not qualify.

A 'qualifying tenant' is a flat-owner who holds a lease granted for a term of over 21 years.

The next step is to check whether those tenants who have expressed an interest in joining with you to pursue a claim for the freehold represent a sufficient proportion of the flat-owners to proceed.

The qualifying tenants who decide to put their names to the 'initial Notice' (see paragraph 3 below) claiming the right to acquire the freehold are known as the 'participating tenants'. The participating tenants must own at least half the total number of flats in the building.

If these conditions are satisfied, then it will be possible to proceed with a collective claim for the freehold of the building.

(Note, however, that the freeholder can resist the tenants' claim on the basis that at least two-thirds of all the long leases on which flats in the building are held are due to expire within the period of five years commencing on the date of the tenants' initial Notice and on the basis that the freeholder intends to redevelop the building in a manner which necessitates regaining vacant possession of the building.)

Preliminary steps

Having established that a collective claim for the freehold should be possible, you will want to make a preliminary assessment of the likely costs involved.

You and the other participating tenants will have to be able to finance the purchase of the freeholder's reversionary interest (and the interest of any intermediate landlord). In relation to flats held on leases with less than 80 years to run you will also have to pay to the freeholder a 50% share of the 'marriage value' which results when the freehold and leasehold interests come into the same ownership (see below). It is of course this 'marriage value' (that is to say, the tenants' 50% share of it) which will represent the chief profitability of the exercise from the tenants' point of view.

In some cases tenants will find themselves not merely acquiring the freehold reversion to their own flats, but also to the flats of non-participating tenants and business premises. They should then regard the purchase not only as a means of acquiring the freehold and so enhancing the value of their flats, but also as a property investment which may not be readily saleable. Sometimes, one or more of the participating tenants are willing to acquire this investment. In other cases, the alternative of making multiple lease extension applications may be more attractive.

At this stage, some valuation advice from a specialist valuer will generally be essential.

The other associated costs of proceeding should also be borne in mind. In addition to your valuer's fees, there will be legal costs – your own and certain costs reasonably incurred by a landlord. In particular, it should be noted that the tenants' liability for these costs is 'joint and several'. In other words, each tenant is potentially liable to pay the whole of these costs whether the other tenants make their due contribution or not. (See comments below regarding an initial costs fund and participation agreement with cross-indemnities.)

A landlord's costs will be difficult to estimate but a general indication can be given.

Costs are bound to be higher where there are disparate interests in the building, for example, intermediate leasehold interests or some tenants holding flats on long leases and others holding on shorter leases. The same is true where there are commercial premises.

Once the likely cost has been established, you and the other participating tenants will need to be satisfied that you will have the ability to finance your estimated apportioned contributions.

This is the stage at which we can prepare the notice of claim and the participation agreement.

All we will need from you and the other participators is a completed questionnaire and for you to either forward to us your respective leases and other title deeds or in each case write to the firm/institution holding them asking it to forward them to us. We will then confirm whether the qualification criteria laid down by the Act are satisfied on the basis of the information provided in the completed questionnaires and having checked the provisions of your leases; other interests in the building; etc.

In the meantime, an agreement should be drawn up and entered into by all the participating tenants. This 'participation agreement' will deal with:

- the participators' respective financial contributions towards the purchase price and all related costs of purchase
- the obligations of the 'nominee purchaser' – almost invariably a company – particularly in terms of granting new extended leases simultaneously with the completion of the purchase of the freehold. (This is likely to be a requirement where a tenant is raising finance by way of mortgage and desirable in almost every case in any event.)
- the obligations of a tenant who wants to sell his or her flat before the claim is determined
- how the proportion of the freehold price reflecting the flats of non-participators and/or commercial units is to be covered
- how decisions are to be taken. There may well be less than unanimity in relation to the question of the prices to be paid for the various interests. Similarly, since a notice to withdraw a claim must be served by all the participating tenants, the decision as to whether to proceed or withdraw at any stage needs to be made in accordance with an agreed decision-making formula
- the setting up of an initial costs fund to cover the costs of the preliminary steps
- cross-indemnities in respect of losses suffered by the other tenants, if one or more tenants fail to comply with their obligations e.g. fail to provide their financial contribution in time.

If it is to be a company (and it will soon have to be, once new statutory provisions come into force), the nominee purchaser will have to be incorporated, its constitution agreed and officers appointed. This is generally a relatively straightforward matter.

If necessary, we will make preliminary enquiries as to the ownership structure of the building in question. As a 'qualifying tenant', any one of the flat-owners who intends to be a participating tenant may serve a notice on the freeholder or the immediate landlord (if different) or an intermediate landlord or the person to whom you pay rent (eg the managing agents) requiring the recipient to give comprehensive information in relation to the various property interests in the building. The recipient of the notice must respond within 28 days.

Before you proceed with your claim to enfranchise, you and the other participating flat-owners will need valuation advice from a specialist valuer. The valuation provisions – which are very technical – have been referred to above. In broad terms, the price payable by the participating tenants for the freehold interest in the building will comprise three elements:

- the open market value of the freeholder's interest in the building (taking account of the fact that it is subject to – and has the benefit of – any existing leases) and possibly also taking account of future development potential;
- the freeholder's share (50%) of the 'marriage value', ie the additional value created by combining the freehold and leasehold interests (Note: if a participating tenant's lease has over 80 years left to run at the date the Notice of claim is served, there is no share of 'marriage value' to pay in respect of the flat in question; and
- (where relevant) any compensation payable to the freeholder for any diminution in value of any other property owned by the freeholder.

The valuation date is the date of service of the tenants' initial Notice of claim (see paragraph 3 below).

Where there are intermediate leasehold interests to be bought out, the price for these will also have to be paid. Compensation may also be payable to the intermediate landlord for any diminution in value of any other property which he owns.

It should be remembered that the reasonable legal and valuation (but not negotiation) costs of the freeholder and any intermediate landlords will also have to be borne by the participating tenants.

Having established that you and your fellow flatowners are in a position to proceed, it is worth considering a direct approach to the freeholder

(and where appropriate any intermediate landlord) or the managing agents to see whether the freeholder is prepared to sell voluntarily. If he is, this will help to keep matters straightforward and costs as low as possible. You will again want advice from a specialist valuer as to the price you should pay for the freehold interest in the building before making an offer to open negotiations with the freeholder. As and when the price is agreed, we can deal with the legalities of the acquisition.

If the freeholder (or any intermediate landlord) is not prepared to co-operate, you and the other flatowners have lost nothing and can immediately take advantage of your rights to acquire the freehold under the Act.

Claim

The claim will be initiated by the service of a tenants' initial Notice claiming to exercise your right to acquire the freehold.

This Notice sets out the basis of your claim giving details of your interests in the building; the realistic price which the participating tenants propose to pay; and the identity of the person or company that will acquire the freehold on behalf of the participating tenants – 'the nominee purchaser'.

The Notice is a complex document and requires very careful consideration as any error may invalidate it and you will have to serve a fresh notice, by which time, of course, circumstances may have changed. The same should be borne in mind in relation to observation of the strict time-limits which apply. Failure to observe these time-limits is fatal to the claim and no fresh claim can be made for 12 months. For this reason, we are careful only to serve the Notice once we are in a position to comply with the relevant time-limits.

The Notice specifies a date by which the landlord must respond, which must be at least 2 months after the date of the Notice.

We register a 'notice' at the Land Registry to protect the claim in the event of a dealing by the landlord with his interest. At any time after the Notice has been served, the landlord may:

- require each of the participating tenants to 'deduce title' to the lease of his or her flat within 21 days. Strict compliance is essential. We will already have each participant's title deeds and so be able to comply;
- exercise rights of access to any of the flats in the building upon not less than 10 days' notice.

Landlord's Counter-notice

The landlord must serve a Counter-notice before the date specified in the tenants' initial Notice (at least two months after the date of the Notice). In the Counter-notice, the landlord will either admit or contest your right to bring the claim to enfranchise collectively and may propose terms for the acquisition of the freehold. (In the unlikely event that the right to enfranchise is contested, any dispute is ultimately referable to the County Court within two months of the date of service of the Counter-notice.)

Conveyancing steps

Once the landlord's Counter-notice has been received (or in any event once two months have elapsed since service of the initial Notice), you may call upon the landlord to produce evidence of its title to the freehold (within 28 days).

We check the landlord's title and make any necessary enquiries within 14 days to which the landlord must reply within a further 14 days.

Notices may be served by either the landlord or you at this stage giving details of any rights of way or restrictive covenants to be included in the Transfer of the freehold.

It should be noted that the building may become subject to an 'estate management scheme' once enfranchised. Such schemes allow the landlord to retain powers of management over the estate in order to preserve the upkeep and general appearance of the neighbourhood which it considers might otherwise be at risk. These schemes may provide for the regulation of the redevelopment, use or appearance of the house; powers for the landlord to carry out works of maintenance and repair (and provisions for the recovery of the landlord's costs incurred in so doing); powers for the landlord to carry out inspections of the property; etc.

Once the right to bring your claim is admitted and while the form of the Transfer is being negotiated, your valuer and the landlord's valuer negotiate the price to be paid for the freehold.

After the first two months of the negotiating period (but in any event before the end of the six months) either you or the landlord can apply to the First Tier Tribunal ('the FFT') to determine the price that you must pay.

As the valuation date is fixed, it will generally be the landlord who makes the application to hasten completion. We need to be ready to make the application in the rare cases where the landlord fails to do so. The vast majority of cases are agreed without the need to go to the FFT. However, if the price issue does go to the FFT for determination, you will face very significant extra costs, typically in the range of £10,000 – £15,000. Matters generally settle ahead of the FFT hearing date because each party has to bear its own costs. It is only worthwhile going to the FFT if the financial stakes are relatively high.

Once the price has been agreed, the Contract is prepared by the landlord's solicitors (within 21 days of agreement of its terms). We propose any amendments within a further 14 days and the landlord responds within a further 14 days.

Exchange of Contracts

Contracts are exchanged (within two months of agreement of the terms) and a deposit (which will invariably be 10% of the purchase price) will be paid to the landlord.

Completion

Following exchange, either you or the landlord may serve a notice requiring completion within four weeks. We prepare the Transfer for approval by the landlord's solicitors and subsequent execution in readiness for completion.

On completion, the balance of the purchase price is paid and any apportionment of rent and service charge is made. Any arrears of rent or service charge (in respect of all flats) therefore need to be settled.

The Transfer is sent to us and any mortgages of the landlord's freehold interest are automatically discharged. Any 'leasebacks' to the landlord required by the Act will be granted; these may be relevant where there is a resident landlord or in respect of premises occupied by non-participating leaseholders.

New Leases

In most cases the nominee purchaser will grant 999 year leases at a peppercorn (or nil) rent to the participating leaseholders in accordance with the participation agreement (see above). Where relevant, the security of any existing or new mortgages over the new leases will be perfected at the same time.

Post-Completion

If applicable, Stamp Duty Land Tax at the appropriate rate is paid on the Transfer within one month of completion.

We then make an application to the Land Registry for the registration of the nominee purchaser as owner of the freehold and for the cancellation of any existing charge over the freehold interest. If appropriate, application is also made for the registration of any lease extensions and any new security taken by a mortgagee over a leasehold interest.

It will generally be the case that no Stamp Duty Land Tax is payable on the grant of the new leases although that cannot always be guaranteed.

Withdrawal

As mentioned above, withdrawal is only possible if all the participating tenants sign and serve a Notice of Withdrawal on the landlord. The effects of such a withdrawal are twofold:

- tenants are prevented from bringing another claim under the Act for a period of at least twelve months (but this does not prevent an individual qualifying tenant from applying for a lease extension during that period)
- the participating tenants remain jointly and severally liable for the costs of the freeholder and any other relevant landlords.

An individual participator may only withdraw to the extent such withdrawal is permitted by the participation agreement.

Can other flat-owners join at a later stage?

For the time being this is only possible if there is agreement on the part of the participating tenants who signed the initial Notice (see paragraph 3 above). If a participator dies or assigns his or her leasehold interest before the freehold procedure has been concluded, the personal representatives of the deceased flat-owner or the purchaser of the relevant lease may generally elect to join in. If they do not, in the former case the flat-owner's estate, and in the latter the flat-owner who is selling, will remain liable for costs.

Costs

As mentioned above, the participating flat-owners will be responsible for certain of the reasonable legal and valuer's fees of the freeholder and those of any intermediate landlord(s) as well as their own costs. Liability is joint and several and so you could find yourself primarily liable for all the costs of the collective enfranchisement procedure and then having to claim an indemnity from the other participating tenants. In practice, this will not be an issue were we hold sufficient contributions from participators on 'day one'.

Conclusion

It is usual for the collective freehold procedure to take between nine and twelve months. However, at the end of the process, you can look forward to

- a rise in value of your flat
- a new 999 year lease at nil ground rent
- a share of the freehold
- services run and service charges set by the flat-owners.

If you are considering a collective freehold claim, we would be happy to advise on all aspects of the matter and to give an estimate of the likely costs.

Experience shows that a well co-ordinated collective freehold claim will proceed to a successful acquisition of the freehold. Solicitors and valuers need to work as an effective team and we can put you in touch with specialist valuers with whom we have worked on numerous successful claims.

First published 20/11/2015.

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