



Collective Freehold Enfranchisement - Enhancement and Development Value

BRIEFING

Introduction

Flat owners acting in concert, who meet certain qualification criteria, have the right to acquire the freehold interest in their building along with certain other interests in return for the payment of a premium. This is often referred to as collective or freehold enfranchisement. In essence it is a form of compulsory purchase.

It was created by the Leasehold Reform Housing and Urban Development Act 1993, substantially amended by the Commonhold and Leasehold Reform Act 2002 and fleshed out by regulations.

This legislation provides a procedure to determine the premium and other terms on which the interests are to be acquired. This includes the extent of the land and rights that the flat owners are entitled to claim as well as the rights and restrictions the landlord is entitled to impose. These terms affect the premium and so it is essential to settle them before being able to finalise it, whether by agreement or determination by the Tribunal.

Enhancement

The ability to impose restrictions, known as “enhancement”, is a potent weapon for the freeholder. For example flat owners’ sole reason for enfranchising may be to undertake development which their leases prohibit. The

freeholder can require the continuation of certain restrictions contained in the flat owners’ leases being negative covenants, such as those affecting the types of alteration that can be made and the use to which the property can be put.

The freeholder can also require the creation of new covenants, insofar as they do not interfere with the reasonable enjoyment of the premises, as they have been used pursuant to the flat leases. It cannot continue or create positive covenants, such as an obligation to keep the property in repair or to insure it.

The reason this is known as ‘enhancement’ is that the only restrictions that can be continued are those which are capable of benefitting other property and to materially enhance the value of the other property. This is a relatively low hurdle as a restriction falls within this category if it is likely to maintain the value of other property which might otherwise deteriorate (*Peck v Trustees of Hornsey Parochial Charities* (1970) 22 P&CR LT at 799, *Le Mesurier v Pitt* (1972) 23 P&CR 389 LT at 398, *Moreau v Howard de Walden Estates Ltd* (LRA/2/2002) LT).

Where the flat owners are motivated to seek the freehold by a desire to develop their flats or the building as a whole (i.e. by converting the flats into a single dwelling or by extending their individual flats into areas that do not belong to them or in a way that their leases bar) they will have to either



negotiate to take the freehold free of these restrictions or fight the freeholder's claim to the covenants before the Tribunal.

Negotiating will involve paying an additional chunk of premium which will represent a fuller share of the development value to be released by their works than they might have expected to pay by way of development value in the event the freeholder had not called for the imposition of the restrictions (of which more below). Fighting will incur significant legal and valuation costs and the risk that if the Freeholder wins on the issue it may then refuse to grant consent for the development at all, which may cause the flat owners to withdraw. This will result in large bills from their own advisors and the freeholder.

Freeholders will need to examine the restrictions contained in the lease carefully to establish the strength of their hand. If, as is often the case, there are restrictions against alterations (i.e. an absolute bar against certain) and they succeed on enhancement, then they will not have to argue for development value. This would otherwise be an uphill battle for them as it requires them to provide good comparable evidence against which sizeable discounts may then be applied for planning and cost overrun risks by the Tribunal.

Where the freeholder does not seek to continue restrictions or is unsuccessful in doing so then its alternative is to seek development value as an additional element of the premium payable to it.

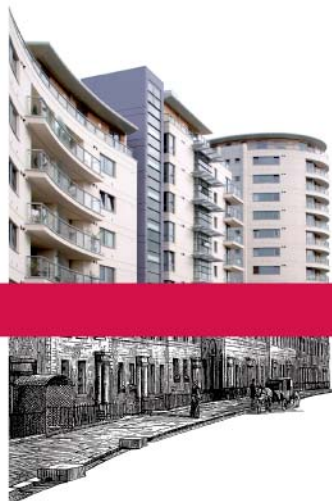
Development Value

Development value is determined by the use of comparables in the usual way or if there are no reliable comparables by a residual valuation (working backwards from the value of the completed development). Discounts will then be applied for planning, costs overrun and other relevant risks. For example a 50% discount was applied in *Arrowdell v Consiton Court (North Hove Limited)* LRA/72/2005.

Flat owners will resent development value as it is payable in respect of any development value that they could release as a consequence of enfranchising the freehold (or which could be released by the freeholder when their leases fall in), even if they have no intention of undertaking the type of development that would unlock it e.g. a roof top development.

For this reason landlords need to be careful not to argue for the continuation of restrictions that would prevent flat owners from being able to undertake forms of development that they are unlikely to want to bring to life, (e.g. a roof top development). This is because the landlord will then have no prospect of being awarded development value in that regard nor of the flat owners knocking on the freeholder's door for consent to undertake such works subsequently.

Freeholders stand to receive different proportions of prospective development value depending on how it can be unlocked.



The most favourable type of development value, from the landlord's point of view, is that which it can unlock without co-operation from the flat owners. An example of this is constructing more flats above or beside the existing block.

If the development value can only be unlocked by the flat owner during the term or by the freeholder at the end of it, such as extending one or more of the flats, then there are two elements of development value (*Forty Five Holdings v Grosvenor (Mayfair) Estate* [2009] UKUT 234 (LC).) This being that released to the flat owner on enfranchisement by him having the ability then to undertake the development at that stage and that available to the freeholder when the leases fall in. In each case the Freeholder will receive only a share of the development value. The former is subject to the marriage value discount of 50% and the later type will be discounted for the wait by applying the deferment rate.

Development value, released by converting a house laid out as flats into a single house, may be complicated by the existence of flats held by non-participants. Their interest would need to be bought out or terminated under s.61 of the Act in order to accomplish a re-development at the term date. In *31/37 Cadogan Square* [2010] UKUT 321 (LC), the Tribunal's approach was to calculate the present value of any development value and discounting by 85% to allow for risks as to the value use as a single house would command when the leases fell in, planning and successfully operating s. 61 against the non participants without undue delay and expense.

Conclusion

In conclusion flat owners must carefully examine their leases to establish what restrictions the freeholder may seek to continue and proceed with their eyes wide open on the issue. Freeholders will need to undertake the same exercise and work out what restrictions to seek to continue. More importantly where there is significant development value they should consider whether it is worth it while seeking planning permission in respect of the same.

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