



Varying Residential Leases - Flaws and Solutions

BRIEFING

This briefing note concentrates on the ability of parties to a lease to vary the terms of that lease.

Why are leases used?

There are various legal mechanisms through which the right to possession of a flat may be held including freehold, Commonhold and leasehold.

For example, a developer may construct a block of flats and then let them out on Assured Shorthold Tenancies. The long term right of occupation of the flats will rest in the freehold.

“Commonhold”, which originated from the Commonhold and Leasehold Reform Act 2002, created freehold like ownership. However take up of this new form of title has been nominal to date.

In the majority of situations, a long lease will be used which is granted when the flat is first sold and then assigned from one owner to another. It provides a convenient and accepted method of granting the right of possession, while doing the necessary job of dividing responsibilities with regard to the flat and the building as a whole between the flat owner and their landlord or even to a third party appointed for this purpose.

Flaws

Unfortunately there are significant flaws with this method of ownership. The right to occupy is

limited to a fixed period of time known as the “term”, which feels odd to those paying a significant premium for the interest and is certainly alien to most foreign investors. The restrictions known as “covenants” contained in leases can be perceived as being too strong a fetter on flat owners’ enjoyment of their flats. It has also been weighed down by case law and legislation that has sought to interpret and amend the contract recorded in residential leases. The net effect is that flat owners often have a stronger hand than it appears from the lease. This leaves flat owners uncertain as to what their position is on any given issue and so reliant on obtaining legal advice.

The quality of leases and the interests of flat owners and landlords have changed over time. Many houses were converted into flats in the 1980s and sold off on leases for a term of 99 years. Over time property has risen in popularity as an asset class, lease terms have become shorter, values have risen and consequently there has been value to be had by developing flats and the buildings that comprise them. The consequent competing interests of flat owners and their landlords has tested the concept of leasehold ownership.

Developers now often sell flats on leases for a longer term of 125 or 999 years. The terms of the leases are more comprehensive and consistent, while a share of freehold may well be included.



Owners of older flats and their buyers have become more conscious of the implications of the remaining term of the lease. As the market tightens, buyers become more selective and shunning what were once accepted lease terms and avoiding leases that contain defects rather than taking a view as they once might have done. Leases are often not flexible enough to cope with changes in the facilities serving the building or the construction of more flats.

Legislation has intervened to enable flat owners to maintain the value of their interest and enjoy their property as they would expect, where they have paid a significant premium for their asset by granting them rights to obtain new leases for an extended term, to resist demands for unreasonable service charge and to seek to vary terms of their leases. It has also strengthened their position with regard to alterations and disposals of their landlord's interest.

Defects in leases are numerous. Some affect the ability of the flat owners to sell their interest and the price they can achieve. Others affect the landlord's ability to manage the building effectively, such as when collecting sufficient service charge to meet its repair obligations.

Flat owners may seek their landlord's co-operation to correct a defect and receive a demand for a premium or rejection in response. Landlords may propose developing the building or estate in a way that requires the existing leases to be amended and be unable to obtain the co-operation of all of current flat owners.

Solutions

The Landlord and Tenant Act 1987 may come to their aid in this situation. It enables parties to a lease to seek the variation of terms of their lease (i.e. to correct defects relating to repairs, insurance and service charges). While relief is discretionary, it is a useful power which remains under-used, despite amendments by recent legislation which transferred the jurisdiction to the Tribunal and so eliminated the risk of adverse costs orders.

Unfortunately these rights do not benefit all leaseholders such as leases granted for a term of 21 years or less, leases containing three or more flats, business leases and owners of three or more flats in a building held via two or more leases.

Flat owners, or their landlord acting alone, are entitled to seek to vary their lease where it fails to make satisfactory provision with respect to repair and maintenance, insurance or the computation of service charges. Where a flat owner applies to vary one flat lease, the landlord has the ability in response to require that consequential variations are made to the other flat leases in the building.

With regard to defects in the repair and maintenance obligations in the lease, flat owners can for example seek the creation of a missing obligation on the landlord's part to maintain the building or external parts used by the flat owner alone or in common with others that have fallen into a dilapidated state.



Defects in the insurance obligations, such as where no one is obliged to insure the building, entitle the flat owner to seek a variation to impose this obligation on the landlord. However this element of the legislation cannot be used to remove the landlord's control over the insurer to be used.

Service charge provisions can be varied but this power is not as useful as flat owners might hope. While the Tribunal has varied the level of interest payable on unpaid service charge and can correct errors in the computation of service charge (i.e. where the total of the contributions due from each flat owner do not add up to 100%) it cannot adjust the flat owners' respective contributions where they do add up to 100%.

Variations can also be sought in relation to the repair and maintenance of installations, which are "reasonably necessary to ensure that occupiers of the flat enjoy a reasonable standard of accommodation". The installations may be outside the flat or even the building.

Wider powers of variation are available to a majority of the flat owners and the landlord acting in concert. They can seek a variation of two or more leases where the aim of the variation cannot be achieved unless all the leases are varied to the same effect, such as to adjust service charge contributions between flat owners. This has been used to change the mechanism for the collection of service charges, to create a reserve fund and to remove obsolete obligations on the landlord's part, such as to provide communal heating when it is

more economic for tenants to provide their own central heating systems.

These rights to seek lease variations only apply to flats. The leaseholder of a house can however seek a variation where their lease fails to make satisfactory provision with respect to insurance.

The Tribunal's powers are discretionary as opposed to flat owners, for example being entitled to a variation as of right, where the relevant grounds are proved. It has a free hand and can make other variations besides those applied for. The Tribunal is unlikely to order the variation sought if it will cause another substantial prejudice and when compensation is not an adequate compensation. Also if for any other reason, it would not be reasonable in the circumstances for the variation to be effected.

Third parties adversely affected by variations are protected. If notified of the proceedings they can seek damages for any loss or disadvantage they are likely to suffer. If they are not notified then they can seek damages for breach of statutory duty and apply for the cancellation or modification of the variation.

Subsequent legislation has strengthened the hand of flat owners. The Commonhold and Leasehold Reform Act 2002 created the right for leaseholders of flats and houses to seek the amendment of their leases with regard to "administration charges", where they or any formula for calculating them are unreasonable.



The Leasehold Reform, Housing and Urban Development Act 1993 grants flat owners the right to seek certain amendments to their existing form of lease when exercising their right to claim a new lease.

Conclusion

In conclusion parties often need to look beyond the terms of the lease itself to see the full picture. Flat owners may well find that unexpected help exists particularly where the freehold has been disposed of over their heads, or when they wish to develop their flat or when their lease is “short” or contains defects.

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