

Labour's new deal for leaseholders

BSA response

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 Building
Societies
Association

Introduction

The Building Societies Association (BSA) represents all 43 UK building societies, as well as 6 credit unions. Building societies have total assets of £415 billion and, together with their subsidiaries, hold residential mortgages almost £330 billion, 23% of the total outstanding in the UK. They hold over £280 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 37% of all cash ISA balances. They employ approximately 42,500 full and part-time staff and operate through approximately 1,470 branches.

Building societies are owned by their members. Borrowers and savers automatically become a member of their society when they take out a mortgage or open a savings account.

While their businesses must be run as rigorously as any plc bank on the high street as societies operate in the same regulatory environment, their purpose is different. A plc must operate to the benefit of its shareholders, a mutual operates to the benefit of its members and takes business decisions in a different way because of this.

The BSA has prepared this response in consultation with its members. The BSA has been engaged in the debate about leasehold/commonhold for several years, we have responded to numerous consultations and have contributed to a number of roundtable discussions with The Ministry of Housing, Communities & Local Government (MHCLG) and the Law Commission in recent times. We will reference some of our previous consultation responses in this paper.

General Comments

1. The BSA welcomes this paper outlining Labour's five pledges for leaseholders. The BSA has long been an advocate for leasehold reform. As far back as 1984, we published a report by a working group of building societies, entitled "Leaseholds – Time for a change?" Whilst we appreciate the complexity of the issues around leasehold, it is fair to say our members and the many leaseholders with onerous terms are frustrated at the lack of progress.
2. It is pleasing to see that this paper seeks to address the situation of existing leaseholders. We have consistently highlighted that the plight of existing leaseholders is not really being addressed in current work streams. We support many of the proposed government changes to leasehold. However, we have repeatedly warned of the emergence of a two tier market where the existing 4 million plus leaseholders face the possibility of having their properties blighted.
3. One area of concern to our members not addressed in this paper is the use of estate rent charges for new build developments. Confusingly this charge is often referred to as a service charge. Essentially this is where the developer would charge the freeholder for managing shared spaces not adopted by local councils. This can include grass cutting in shared areas and maintaining private roads. It appears that some developers are now using this mechanism to engage in further egregious exploitation

of home buyers and to compensate themselves unfairly for the loss of additional income streams generated from ground rent.

4. We believe that Local Authorities should adopt all new build estates on completion. The additional council tax paid by the new property owners should pay for the council to adopt and maintain the estate. Unfortunately, some local authorities choose not to adopt the land which the developer then manages via an estate charge. This can often lead to freeholders being exploited. “Fleecehold” is the term widely used to describe this practice. We are aware that some local authorities have tried and failed to place clauses in planning consents to ensure developers hand over the land on completion of the developments. This practice must be stopped by making the handover of housing developments to local authorities a condition in the planning process. This would have the added benefit of ensuring the work is of a standard that the local authority would accept.
5. It is unfortunate that despite Government’s high profile work on leasehold, some developers continue to exploit consumers. Our members have provided some examples of recent developer behaviour:

Example 1

A new housing estate, where roads and amenity areas will not be adopted by the local authority upon completion and will be managed by a new private maintenance company. An initial charge of over £1,000 per unit was proposed, which would be reviewed annually such that on a 250 property estate this monopoly service provider will effectively receive £250,000 per annum for grass cutting, as the roads will not require any substantial maintenance for years to come. It is likely the developers will eventually sell this company on to the highest bidder thus making substantial capital profit likely to be in the range of £10,000 to £20,000 per property.

Example 2

A rent review clause that linked the Ground rent increases to RPI, but then in the detail of the appendix noted that there was a minimum percentage, compounding, annual increase which would apply irrespective of the RPI.

Example 3

Developers seeking 5 year reviews rather than the previous “norm” of 20, 15, or at worst 10 year review patterns.

Example 4

We have seen a number of cases where there is a “transfer charge” comprising a one-off payment calculated as say 0.25% of the sale price for every full year that the property has been owned, on any subsequent sale. For example, if a customer sells a house for £250,000, that they have owned for 10 years then the developer will require a payment of $(10 * 0.25\%, \text{ of } £250,000) = £6250$ in order to obtain “permission” for the sale to proceed.

Often our members’ threat of not offering the mortgage on these terms causes the developers to remove or amend some of these onerous clauses. However, we remain

concerned that some unscrupulous developers are searching for any conceivable avenue of exploiting customers. It is time that this sharp practice was eradicated.

6. We welcome the question around “lease forfeiture”. It is a scandal that this archaic law has not been abolished. We are supportive of the work undertaken by the Law Commission in 2006, which unfortunately is gathering dust. It is a common occurrence for our members to be aggressively pursued by freeholders when ground rent is not paid by mortgagors. Members are given a hard 28 day deadline, and lawyers acting for freeholders are often unwilling to discuss the situation or offer any flexibility. Often those who have arrears on ground rent have arrears on their mortgage payments. Mortgage lenders offer forbearance in line with FCA guidance as well as dealing sympathetically and positively with vulnerable customers. However, our members have to pay ground rent arrears immediately on demand to avoid forfeiture of the customer’s home.

Consultation Questions

Should there be any exemptions to the prohibition on new private leasehold properties and if so what should they be?

We are supportive of recent Government proposals to abolish leasehold as a tenure for new build houses with some exceptions. However, we **do not** believe that leasehold should simply be abolished. With over 4 million leasehold properties, we firmly believe the priority should be on addressing the onerous lease terms suffered by some leaseholders. It is important that commonhold is not seen as a panacea for the issues with leasehold but instead be another option alongside a better functioning leasehold market.

We must not lose sight of the fact that many leaseholders are happy with the current system and may not be attracted to being part of a commonhold association. Both leasehold and commonhold should continue to be available as tenures for all housing types.

However, Government, local authorities and regulators should be empowered and prepared to act swiftly and punitively against developers and freeholders who seek to exploit homeowners unfairly through egregious ground rents, estate charges, service charges and any other similar schemes they cook up. The mortgage industry should play their part too and should work closely with Government, local authorities and regulators to achieve equitable outcomes for homeowners.

The advantage of this approach would be to maintain real choice of tenure and allow both public and private providers of homes the flexibility to meet the genuine needs of families, working people and the older generations.

For example, in those parts of the country where the cost of land is such that decent genuinely affordable housing is virtually impossible to provide on a freehold basis for key workers and ordinary working families, the creative use of leasehold could provide an effective solution. With a responsible freeholder (a local authority, the NHS, ethical private landowners), homes could be developed, built and sold on a long leasehold, with the sale price based on the cost of construction with a fair ground rent. Restrictions on sale could ensure that the benefit of such arrangements are preserved for subsequent owners. Schemes of this sort could sit comfortably alongside local authority and social housing, enabling more people to fulfil their

dreams of home ownership and, at the same time, freeing up vital funds to enable local authorities and others to build more genuinely affordable homes for rent or purchase.

This approach also has the advantage of avoiding the blight that could otherwise affect the existing stock of leasehold properties.

We believe local councils should be required to adopt all road/land in private developments. Developers should continue to make the necessary contributions to fund this alongside the additional Council Tax that will accrue to the local authority from the new homeowners. This would mean there would be no need for estate charges.

Whether Labour accepts the case set out above or not, we agree with the principle of an exemption for shared ownership homes. However, this should be contingent on adherence to the fundamental clauses set out in Homes England's model lease. This should apply equally to registered providers and private shared ownership providers. BSA members have provided examples of where shared ownership providers are not adhering to the terms of the model lease set out by Homes England. This can make it challenging for lenders to understand to what extent customers are being protected from unfair terms.

For example, one member has received a small number of post-offer queries from solicitors regarding higher/escalating ground rents, some of which are greater than 0.1% of the value. Members have also encountered variations to the shared ownership model lease, with the registered providers often being unwilling to negotiate. We have also seen evidence of cases where the ground rent doubles every 25 years.

Where registered providers receive grant funding from Homes England, they must adhere to fundamental clauses in the model lease. Anecdotally, we have been told that where grant funding is not being used, in particular on Section 106 negotiations, variations in the terms of shared ownership leases can occur. For lenders and their customers this can be confusing, as they will often be unaware at the point of sale whether any particular scheme is grant-funded or not.

We would recommend an exemption for shared ownership but only on the basis of adherence to the Homes England Model Lease.

What changes need to be made to commonhold to ensure it can become the default tenure for new flats?

We do not believe that commonhold should become the default tenure for new flats, but instead operate alongside a better functioning leasehold market. It is often stated that one of the reasons commonhold has not succeeded is the fact that lenders will not lend on this tenure. We disagree with this assumption. Previous research undertaken by the BSA indicated that 57% of Building Societies in England and Wales would be willing to lend on commonhold. Other members have told us they would consider lending on this tenure, however, significant investment in process design and upskilling staff would be wasted in the current market due to the lack of supply.

The debate needs to be better informed. There is a large education piece required to understand the pros and cons, not just for existing property owners but also for the various property professionals involved in the purchasing process.

The BSA responded to the Law Commission's paper on reinvigorating commonhold. I have highlighted some of the concerns raised in our response below:

Enforcement/Dispute resolution

The proposal for a commonhold association to automatically have a first charge over a commonhold unit in case of the non-payment of contributions would be challenging for mortgage lenders. Mortgage lending comes with many risks attached. Mortgage lenders have to mitigate these risks carefully whilst providing finance at a competitive level for home buyers. The first principle for mainstream mortgage lending is to have the first charge over the property as this protects the lender's security. Clearly there needs to be a mechanism that ensures each unit holder pays their fair share. However, this should not take priority over a lender's security. The absence of a first charge could mean that mortgage lenders take a more cautious approach to lending, which could mean a limited appetite for higher loan to value lending.

We have a further meeting with the Law Commission to discuss their proposals for commonhold. It is important that mortgage lenders are comfortable with the risk in lending on commonhold properties, as they will understandably be cautious if there are fewer protections than with other tenures.

In its current form mortgage lenders could apply further conditions to adequately protect their security, such as:

- The borrower to do all things necessary as regards to the maintenance and continuation of the commonhold.
- The borrower to maintain appropriate insurance and make all commonhold contribution payments on time.
- The borrower to report any significant issues, disputes or financial issues affecting the commonhold to the Society.
- The borrower to provide copies of material notices/correspondence from the Commonhold Association to the Society.
- An undertaking from the seller's solicitor that all commonhold contributions will be paid in full prior to completion.

Voluntary termination/Insolvency of a commonhold

The Law Commission discussed mortgage lender concerns around the event of a commonhold association being voluntarily being wound up. They state:

"THERE APPEARS TO BE A PRESUMPTION IN SECTION 51(4) OF THE 2002 ACT THAT A SUCCESSOR ASSOCIATION WILL BE APPOINTED; WE THINK THAT THIS PRESUMPTION SHOULD BE MADE MORE EXPLICIT"¹

It goes on:

"It appears that there may be a power in section 52(4)(d) of the 2002 Act for the court to impose conditions before a succession order can be made, allowing a successor association to take over from the insolvent association. We provisionally propose that this power should be clarified so as to ensure that it is not used as a way of undermining the principle that a

¹ Section 7.57 – Reinvigorating Commonhold: The Alternative to Leasehold Ownership. Law Commission Consultation.

*successor association is not liable for the debts of the previous association, except in clearly defined circumstances”.*²

We agree that clarity is required here to ensure the appointment of successor associations in the event of insolvency and we are supportive of 7.63 which states:

“Additionally, we do not think that the liquidator should be able to demand further contributions to cover:

- (1) Reducing the level of insolvency; or
- (2) Requiring solvent members to make up the shortfall in contributions from members who are bankrupt or from whom it is impossible to make a recovery.”

Conversion to commonhold

We note the two options proposed by the Law Commission to help enable conversion of leasehold properties to commonhold. We are not supportive of either proposal.

Option 1 - requires at least 50% of leaseholders to support it, so essentially a development could have a mix of commonhold and leasehold properties. Our members carry out extensive credit/property risk work before agreeing to lend against a property. In this scenario they have lent on the basis of the entire development being leasehold and have not accounted for a mixed development which would bring considerable uncertainty as an untested concept. A mixed development would certainly bring a great level of complexity for buyers, lenders and conveyancers.

Option 2 - would require the support of 80% of leaseholders and essentially convert all lease arrangements to commonhold. This is not a viable option for mortgage lenders and leaseholders as essentially they would be forced to accept their security converting from leasehold. This would mean a lender who makes a commercial decision not to lend on commonhold could be placed in the position of being forced to accept their security changing tenure. Lenders should retain the right to object to a conversion as the first charge holder and the independent commercial decision to either adopt commonhold or chose not to, should be respected. Any compulsion would have unintended consequences which could lead to a much more cautious approach to property risk and lending generally, which could have a wider impact on the property market.

It is important that new commonhold proposals work for all parties, including mortgage lenders. The conversion of over 4 million Leasehold properties to commonhold is a huge and complex task. We currently have a handful of commonhold properties across the whole country. As a tenure it has not been testing on any meaningful scale, any conversion on such a massive scale is fraught with danger and possible unintended consequences. We suggest a pilot where only commonhold is available for new build property for a period of time, perhaps in one or two local authority areas. A full evaluation should be carried out after 12 - 24 months to fully evaluate the success and challenges of the tenure, this can then be used in future policy formation.

Do you agree with our proposals to restrict ground rents to zero, or a peppercorn, for new build properties?

Yes.

² Section 7.58 – as above paper

Do you agree with our proposal to set the maximum ground rent chargeable at 0.1% of property value, with a cap of £250 a year?

Yes.

Do you agree with our proposed formula to allow leaseholders to buy the freehold to their home, or convert to commonhold?

We agree with a simple fair formula for leaseholders to buy the freehold of their home. In terms of conversion to commonhold this becomes complicated. Some lenders may make the decision not to lend on commonhold, they essentially would be forced to accept conversion to a tenure they may not be geared up to support. An unintended consequence may have a wider impact on the market with some lenders opting for a more cautious approach to lending on non-freehold properties, an example of this could be not offering higher Loan to Value (LTV) products.

Do you agree that there should be a route for redress for leaseholders suffering from unreasonable costs and conditions?

Yes, the current system is clearly not fit for purpose. We believe there is a need for a Leasehold Ombudsman Scheme in the same way as there is a need for a New Homes Ombudsman Scheme. In most cases of dispute, relying on stretched Trading Standard's resources is ineffectual and referring to the First Tier Tribunal impractical. A Leasehold Ombudsman scheme could consider those complaints and issues not covered by other ombudsman schemes such as the Legal Ombudsman.

We believe the Developers Public Pledge for Leaseholders is too high level not going far enough without any provision for consumer redress.

There are many different streams of on-going work to tackle the issues with leasehold/commonhold including; Right to Manage(RTM), dispute resolution and enfranchisement. It is important that this work is aligned to achieve the best outcome for consumers speedily. Although current Government work is encouraging, there is no clear end date in sight for consumers, which is disappointing considering the problems have been clearly identified for many years.

What types of covenants or administration fees should be permitted and what is a reasonable level to charge?

We welcome Labour proposals for publishing a reference list of reasonable charges. Positive covenants that protect the value of the home and neighbouring properties should remain. Examples would include the requirement to maintain a fence and shared drives/roof etc. It is unfortunate that the majority of fees we have come across tend to be solely implemented as an additional income stream for developers.

Some of the onerous fees we have come across include; fees when selling the property, fees to remortgage, excessive permission fees (hundreds of pounds) for minor property amendments, adding a doorbell, sky dish etc.

Whilst we accept there is a cost to some of this administration, any charge should be reflective of the actual cost. We support moves to cap fees for reasonable charges.

Do you agree with our proposals to abolish forfeiture on long leases?

Yes, see general comments.

What more could be done to give leaseholders more control over management of their buildings?

We agree with improving RTM to simplify the process for leaseholders taking control of their building's management, and the removal of restrictive conditions in the RTM process. We are pleased that this paper recognises the complexity of managing particularly large blocks or estates, where the expertise and attention of a full-time professional is required. Where more responsibility for management is handed over to individual property owners through either commonhold or RTM it is crucial that they have the skills required to ensure effective management.

We are aware of examples of the friction caused where flat owners in small blocks have become joint freeholders or elect to self-manage. Management of shared dwellings is a complex undertaking. Our preference would be for a professional person to be employed at all times. We appreciate this may not always be practical for smaller developments. In this scenario we would advocate a central training programme which has a dedicated support resource.

How can we best ensure effective management of commonhold or Right to Manage sites?

As stated in the previous answer we feel a professional should be involved or a dedicated support resource including a training program for individuals who self-manage. This will be a key to the success of commonhold or RTM. The BSA are happy to support in the development of this policy. Our members will play their part in supporting initiatives that help consumer education, and support the protection of the customer's property.

Conclusion

We welcome Labour's proposals and would be more than happy to discuss this response with interested parties.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £400 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.