

Reinvigorating Commonhold: The Alternative to Leasehold Ownership

Law Commission Consultation
Response

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 Building
Societies
Association

Introduction

The Building Societies Association (BSA) represents all 43 UK building societies, as well as 4 credit unions. Building societies have total assets of over £400 billion and, together with their subsidiaries, hold residential mortgages of over £320 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.

The BSA has prepared this response in consultation with members, rather than answering each individual question we have provided a general response from the perspective of mortgage lenders.

General Comments

The BSA welcome the opportunity to respond to this consultation on reinvigorating commonhold, which goes hand in hand with the wider programme of leasehold reform.

Fewer than 20 commonholds have been created since the Commonhold and Leasehold Reform Act 2002. This can be contrasted to over 4 million leasehold properties, we firmly believe that government should continue to prioritise and focus on addressing 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 forget that leasehold as a tenure works for many leaseholders and not lose sight of the fact that some leaseholders are happy with the current system and may not be attracted to being part of a commonhold association. We are aware of examples of the friction caused where flat owners in small blocks have become joint freeholders or elect to self-manage, there are many cases where owners welcome the “objectivity” of having a separate freeholder.

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

There continues to be a perception that a major reason for the failure of commonhold is lenders unwillingness to lend on this type of tenure. This is both unfair and a lazy argument, previous research undertaken by the BSA indicated that 57% of building societies lending in England and Wales would be willing to accept commonhold. Other members have told us they would consider lending on this tenure however process design and upskilling of staff would be wasted in the current market due to the lack of supply.

Government could play a role in getting all involved in the property chain together to explore this further, as without the support of all parties commonhold may again struggle to gain any traction.

The BSA continue to be a strong advocate of leasehold reform and we remain supportive of a commonhold approach that works for all. We are pleased that the Law Commission has

attempted to address lender concerns within this paper however we remain unconvinced that the proposals will encourage more lenders to lend on commonhold.

Enforcement/Dispute resolution

We welcome the proposals around adequate insurance and the provision of a reserve fund to ensure the maintenance and long term stewardship of a development. However we caution that payment to reserve fund would be classed as a committed expenditure and therefore used by mortgage lenders to calculate affordability of a mortgage and how much they will lend to an individual. It is therefore important that these charges remain proportionate.

The proposal for a commonhold association to automatically have a first charge over a commonhold unit in case of the non-payment of commonhold contributions would not be acceptable by our members. Clearly there needs to be a mechanism that ensures each unit holder pays their fair share however this should not take priority over a lenders security.

Most parties agree that the current law around “lease forfeiture” is disproportionate and not fit for purpose, commonhold clearly has an advantage over leasehold in this respect. However, we would continue to urge this archaic law be revisited and fully support the Law Commission’s work in this area.

Section 14.50 gives an example of how a commonhold association would lose out financially in the absence of a 1st charge. However, from a lenders perspective if you turn this example on its head, i.e. a property with a high loan to value with little equity it would be the lender who loses out financially. The absence of a 1st charge would mean lenders having to consider this additional risk which could limit appetite for higher loan to value lending on commonhold properties.

Voluntary termination/Insolvency of a commonhold

We would welcome more clarity around a lenders position in the event of a commonhold association being voluntarily being wound up. In the absence of a 1st charge it is crucial that lenders have confidence in their security. This needs to be explored further with our members and we welcome the Law Commission arranging a further roundtable for lenders.

In terms of insolvency 7.57 states:

“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”

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

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 in the consultation to help enable conversion of leasehold properties to commonhold, unfortunately 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 unacceptable position of being forced to accept their security changing tenure.

Lenders should retain the right to object to a conversion as the 1st 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.

Conclusion:

We continue to believe that Commonhold has some advantages over leasehold such as; no time-limited ownership, removal of lease forfeiture, no onerous leasehold conditions. These current proposals still leave an element of doubt and uncertainty amongst our members, more engagement and flexibility in the proposals will be needed to find a solution that is fair on the property owner and the lender.

If commonhold were to be “reinvigorated” it must be accepted that there will be an adaption period for the property market. Buyers currently pay a premium for conveyancing of leasehold property due to the added complexity, how do we ensure they do not pay a further premium for commonhold purchases? There also seems to be an assumption that costs will reduce for homeowners under a commonhold structure, home owners will still be required to contribute to the up keep of the property and in addition pay towards a reserve fund which means this may not be the case.

Lenders rely heavily on valuer’s expertise when lending, valuers rely on comparables to value property, with there being so few commonhold developments this task is very challenging.

We appreciate a great deal of effort and resource has been placed in this work, however without the support of developers in adding to commonhold supply we feel this good work could be a wasted effort.

We are happy to discuss any of the above points in more detail.

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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.