BRIEFING

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Snowball Asset Limited v Huntsmore House (Freehold) Limited : Can freeholders retain the ability to develop common parts when flat owners enfranchise the freehold?

Developers might assume that the answer is to simply pack flat leases with the appropriate development rights.

Unfortunately the case of Snowball Asset Limited v Huntsmore House (Freehold) Limited [2015] UKUT 0338(LC) has shown this may not be sufficient protection.

Developers may be surprised to hear that for example express rights reserved by the flat leases were ineffective in the face of the way in which the scheme had been marketed for sale originally.

This case demonstrates the need for freeholders to carefully consider whether they might wish to undertake further development of the site before they sell off flats as they may not be able to preserve their position in this regard in the flat leases and certainly they will need to be very specific in terms of rights reserved to have a hope of achieving this.

Statutory framework

What can be acquired?

The primary right conferred by Part 1 of the Leasehold Reform Housing and Urban Development Act 1993 (the '93 Act) is for qualifying tenants of flats contained in premises to which the legislation applies, to have the freehold to the same acquired on their behalf by a nominee appointed for that purpose and at a price determined under that act.

In addition qualifying tenants are entitled to acquire the freehold to external property where it falls within one of two limbs:

- Firstly they can acquire appurtenant property that is demised by a lease held by a qualifying tenant of a flat contained in the relevant premises so broadly any garage, outhouse garden, yard or appurtenances belonging to or usually enjoyed with the flat.

- Secondly property which a qualifying tenant is entitled under the terms of the lease of his flat to use in common with the occupiers of other premises may be claimed. It might be communal gardens or sports facilities such as a gym, tennis court, swimming pool or sauna.

With regard to the second limb "visual amenity" as it's known isn't enough and so for example garden areas which the lessees can look at but are not entitled to access can't be claimed. "

In common" excludes parts such as a parking space used as of right by particular tenants; a first come first served situation is required. Use in common with occupiers of another building is sufficient.

The freeholder can satisfy a claim for freehold interest in property under this second limb by, amongst other things, instead granting equivalent rights over the property (or any other property). They must be such "permanent rights as will ensure that thereafter the occupier of the flat

referred to in that provision has as nearly as may be the same rights as those enjoyed in relation to that property on the relevant date by the qualifying tenant under the terms of his lease" (section 1(4)(a)). This is known as the 'equivalence test'.

This case concerns the second limb.

What about leasehold interests?

It is also worth noting that certain leasehold interests may be acquired; any element of leasehold interest that sits between the lease of a qualifying tenant and the freehold must be acquired; common parts of the relevant premises or external parts that the freehold may be claimed in respect of as above may be claimed insofar as it is reasonably necessary for the proper management/maintenance of the common parts. This includes a lease of caretaker's flats, roof space and airspace above it. Interests may be severed as necessary and rent apportioned.

They do not have to acquire all that they could such as an element of air space that carries pricey development value.

They are not entitled to acquire leasehold interests in other parts of the building such as commercial units or flats on short leases. It is usually within the freeholder's discretion whether to retain possession of such parts (by receiving a leaseback of such units).

Intermediate public sector landlords are, broadly speaking, immune to having their leasehold interests acquired.

What about other land?

The freeholder may require the tenants to acquire freehold property which would cease to be of useful benefit if it was severed from those being acquired (Section 21(3)(c)) and (4).

The right/obligation does not extend to underlying minerals where the owner of the interest requires the minerals to be excepted and proper provision is made for the support of the property as it is enjoyed on the relevant date.

So how does this work in practice?

The world before snowball

If the freeholder wishes to retain the freehold to common parts then it must offer rights that meet the equivalence test. To be able to develop that retained land the nature of the rights it must offer and those it is able to reserve are crucial.

This seems straight forward from the point of view of a freeholder which has had the opportunity to draft the leases with this in mind however there are traps that can leave the freeholder without title to the common areas or decent compensation for its loss.

What rights must be offered?

If the rights offered by the landlord satisfy the equivalence test at s1(4)(a) then the Tribunal has no discretion to order the transfer of the freehold of the land; it will only have the power to settle the wording of the rights offered (Shortdene Place (Eastbourne) Residents Association Limited v Lynari Properties Limited).

The freeholder does not have to set out the proposed rights in detail; in Hemphurst Limited v Durrels House Limited (unreported December 2010, 2008 LVT) the Tribunal was satisfied that the landlord's proposals met the above test even though they were drawn in general terms.

To meet the test the freeholder needs to make it entirely clear in their counter notice that they are proceeding on the basis that "*in order to retain the freehold of the additional premises it is prepared to grant whatever rights may be required however extensive in order to fully satisfy the equivalence test in Section 1(4)*"

The lease contractual rights as they are affected by the laws of England must be granted and so the service charge obligation must include reasonableness restrictions to mirror the statutory protection tenants enjoy under their leases (Fluss v Queensbridge Terrace Residents Limited [2011] UKUT 285(LC).

What about areas that have been adopted?

Elements of the development that have been adopted shouldn't be forgotten; the freeholder may need to build beneath them.

Can the lease grant rights on one hand to meet this requirement and reserve development rights elsewhere on the other?

The equivalence test assesses the counter notice as a whole not just the rights offered in isolation; the freeholder will fail this test if the rights offered are not equivalent when rights reserved or the ability to modify them elsewhere are taken into account (Ulterra Limited v Glenbarr (RTE) Co Limited [2008] 1EGLR.103LT).

Can the freeholder continue rights to impose regulations or modify rights granted into the freehold title?

No the position will be frozen as at the date notice is given; "the statute… requires an enquiry as at the relevant date.. of what were the rights *enjoyed by the qualifying tenants under their leases on that date. The fact that at some future date they might have enjoyed lesser rights is not relevant…".* Nor could it retain the ability to allow the occupants of new units to use the land or continue the condition precedent to enjoyment of the rights that the users strictly comply with all of the covenants (Fluss).

So what happened in Snowball?

Snowball Asset Limited v Huntsmore House (Freehold) Limited concerned a modern and so very freeholder friendly form of lease. The freeholder benefited from extensive development rights and so it seemed a good opportunity to improve the position of freeholders from the previous leading case of Fluss.

Unfortunately besides the immediate loss for the landlord concerned this case has produced a binding interpretation of the equivalence test that is even more anti freeholder.

The freeholder had certain development proposals involving the demolition of the leisure complex with the construction in its place of some additional residential units and a replacement underground swimming pool sited under the existing garden area. Planning permission had not been obtained.

The freeholder failed in its assertion that the terms of the existing leases granted it sufficient rights to carry out the development and consequently the freehold was lost for £10,000 both at first instance and on appeal.

The freeholder had deployed an "omnibus clause" in the counter notice designed to satisfy the equivalence test come what may but that didn't assist as rights reserved elsewhere in the counter notice are taken into account.

Nor could the freeholder rescue the position by making the rights offered compliant after the counter notice had been given.

The equivalence test is undertaken against an examination as to whether the rights expressly reserved in the lease are in fact effective taking into account the factual background of the development. "Permanent rights" does not mean granting rights that will last the course of the 999 year lease the tenants might grant themselves such that if the lessee's enjoyed precarious rights which could at any time be curtailed or determined then after enfranchisement they should enjoy rights that bear the same frailties. It means assessing what rights are enjoyed at the point the claim is made and replicating them.

In this case the marketing inducement at the time of the original flat sales trumped the subsequent lease terms – for example the contention that the freeholder had the ability to amend the extent and type of facilities made available to the lessees over time was broadly rejected; the wording of the lease was to be construed against the background of the way the development was constructed and marketed being to include a garden and leisure complex for the exclusive use of the tenants;

"*a purchaser of a lease of a flat would in my view have been astonished to be told shortly after his purchase was completed that the freeholder had the right forthwith and without reason permanently to withdraw the right to use the gardens and the leisure complex subject only to allowing an adequate right of access to …the … flat .. so remarkable a right will in my view need to be conferred by clear language if it were to exist.* I conclude that once a facility is allocated and provided for the use of lessee's then it will thereafter remain so allocated and provided. *[so] a facility such as the leisure complex is allocated and provided out and out and with no restriction and is so allocated and provided in circumstances where the intention is clear that lessees will continue to enjoy such a facility then there is no right to withdraw the provision and allocation of this facility*" (para 67).

Consequently the lessees' rights to use the common facilities including the gardens and leisure complex was not a precarious right.

It is worth noting that the freeholder was hampered by the way in which two separate development clauses contrasted.

Conclusion

Freeholders need to review their portfolios in readiness for an enfranchisement claim being made; they may be able to take steps to improve the terms on which they can retain common parts or alternatively the compensation they may receive in respect of them.

It is not certain that a freeholder has the benefit of the rights expressly reserved by the lease and so their development plans may be frustrated. They need to be sure of their ground before they invest in a potential development as if an enfranchisement claim is triggered they may not receive adequate compensation even to cover the investment in planning consultants.

Further information, please contact:

Mark Vinall | Partner
T: 020 7593 5163
E: mvinall@wslaw.co.uk