



May 2018

Overview

Following the publication of the second bulletin, Winckworth Sherwood have maintained an active dialogue with various interested stakeholders in respect of the Government's ongoing programme of leasehold reform.

In summary, since the last Bulletin:

- The Rt. Hon Sajid Javid MP was replaced as Secretary of State for Housing, Communities and Local Government by the Rt. Hon James Brokenshire MP. This follows Mr Javid's move to the Home Office following the resignation of the Rt. Hon Amber Rudd.
- In a [statement](#) to the House on his departmental responsibilities (30/04) Mr Brokenshire cited the Department's plans to tackle unprofessional estate agents and managing and letting agents, indicating his intention to continue with the reforms outlined in the policy paper '[Fixing our broken housing market](#)'.
- The Leasehold Reform Group (LRG) submitted a [response](#) to the Law Commission's eight week call for evidence to support its consultation on commonhold law to [help make commonhold more common](#). This came to a close towards the end of April and the Commission is now analysing responses. The LRG is engaging with the Law Commission on an ongoing basis and will continue to do so.
- On 15 March the former Secretary of State, Rt. Hon Sajid Javid MP made a [statement](#) on building safety in which he responded to Barry Sheerman MP's request to bring together relevant parties to discuss the cost of remedial work. Mr Javid stated that he was in the process of convening a roundtable with freeholders, builders and policymakers which will be taking place over the coming weeks.
- On 17 May the final report from Dame Judith Hackitt's [review](#) of building regulations and fire safety was published. In Brokenshire's subsequent [statement](#) to the House he called for "clarity and accountability" over who is responsible for building safety during construction, refurbishment, and ongoing management of high rise homes. He said that legislation would be introduced to deliver lasting change, beginning with a Government consultation that will look into banning flammable cladding – something the review did not propose. The day before this, on 16 May, Louise Ellman MP (Liverpool, Riverside) tabled an adjournment [debate](#) on Fire Safety Cladding at Heysmoor Heights which focused on the issue of fire safety costs in the private sector.
- On 21 May the Law Commission hosted a meeting of the enfranchisement stakeholder advisory group. Participants of The LRG welcomed the opportunity to discuss the matters related to enfranchisement and valuation with the Law Commission. However, the industry remains concerned about the limited appetite from the Law Commission for input from the private sector and valuation experts.



Managing agents and resident management systems survey results

In the previous Bulletin we outlined some of the shortfalls of commonhold as experienced by residential management companies in this Forum. As part of the response to the Law Commission's call for evidence on commonhold, a number of institutional freeholders conducted an extensive survey of managing agents who manage approximately 400,000 homes across the country. The purpose of the survey was to identify the problems that most commonly arise with leaseholder-owned companies on leasehold developments. The survey produced a number of interesting results and some of the most noteworthy findings were:

- All resident managers surveyed highlighted at least one concern with resident controlled management companies and many marked multiple concerns. Most prominent were the absence of volunteers for the role of director (100 percent), health and safety (80 percent), and directors not acting in the long term interests of the scheme (73 percent).
- 60 percent of respondents had experienced challenges relating to insolvency or lack of funds for residential controlled management companies and in 18 percent of cases these were resolved by a loan from the freeholder.
- The majority of respondents thought there was a need for greater regulation of resident led management companies and their directors. This was in relation to financial control (73 percent agreed), health and safety (73 percent agreed) and safeguarding the long term viability of developments (85 percent agreed).

Challenges around fire safety

In addition to the managing agents' survey, contributors to the Forum have collected a number of case studies relating to post-Grenfell fire safety issues and the replacement of cladding on certain apartment buildings.

In 2016, Ground Rents Income Funds plc (a Real Estate Investment Trust specialising in the investment of residential ground rents across the UK) had a fire safety incident in a building in Manchester for which it was the institutional landlord. A fire occurred in the building as a result of an arson attack to a car parked in the car park below. After an assessment which highlighted the need for a range of remedial works – including internal smoke damage repairs, replacement of external cladding and replacement of decking - the fire service issued binding advice regarding interim mitigation measures. This included a 24/7 two or three person waking watch service until the cladding could be replaced or fire safety systems enhanced.

Due to a shortfall in funds of circa £80,000, and as leaseholders pay via a direct debit, works could not be funded immediately without varying the direct debit, resulting in a need for a £7,000 a week waking watch on site whilst works were pending.

The landlord provided an emergency loan to the service charge account so that work could commence immediately and leaseholders were given much longer to pay the extra amounts required. Without restricting the disposable income of leaseholders, this ensured the immediate safety of residents and removed the requirement for the waking watch which minimised costs to the leaseholders.



Given the circumstances set out above, and with many other properties currently in similar situations around the UK, it would be difficult to see how this problem could have been resolved without a professional institutional landlord with the necessary funds, knowledge and commercial relationships to oversee this vitally important process. This is a useful illustration of the tangible value which institutional investors bring to leaseholders under the leasehold structure.

This property has been subject to two RTM applications; one of which failed and the other currently ongoing. If the property was owned by a commonhold or even RTM structure, the costs of the required works would have had to be collected via the service charge throughout the current service charge year. This would have had to take place prior to instructing the works mandated by the fire service and would have resulted in a scenario where a waking watch would be required on site for a longer period of time to satisfy the fire service. By that point the costs of the overall works (including a waking watch) would have been significantly higher and arguably may never have been collected in full from the leaseholders.

Affordable housing case study

Government proposals to set all ground rents on long leases for houses and flats to zero financial value have caused concern amongst contributors to this Forum. Setting ground rents to zero financial value will hinder the construction of new homes in the UK as ground rents form a crucial element of profitability for housebuilder's developer appraisals. This is particularly concerning for the smaller and medium sized builders who are making representations separately.

One example of this is in Reigate, where Churchill Retirement Living is currently re-negotiating a Section 106 Agreement on a development of 31 retirement apartments. Due to the specialist nature of the proposed accommodation, Churchill had previously agreed a financial contribution of £240,000 to Reigate & Banstead Borough Council for the provision of on-site affordable housing at a rate of 30%. However, following the Government's decision in December to prevent ground rents being charged on new residential developments, Churchill has been forced to renegotiate its contribution to £136,492. This equates to a provision of on-site affordable housing at a significantly reduced rate of 17%.

In this case, and many others, the Government's decision to reduce ground rents to a peppercorn is causing a significant reduction in the financial viability for developers to provide affordable homes. The reforms are likely to lead to many such re-negotiations to take place across the country.

If the plans to reduce ground rents to zero financial value are pursued, the Government risks undermining much needed investment from the private sector and thus failing to meet its ambitious commitment to build 300,000 new homes a year.

In defence of ground rents

Last month, Guy Fetherstonhaugh QC wrote an article for Estates Gazette 'What on earth is ground rent for?' setting out reasons to abolish ground rent on new leases. Simon Allison, Barrister at Hardwicke, produced a counter argument published on 26 May ([click here](#)).



Allison outlines the essential role ground rent incomes play in enabling developers to secure funding for housebuilding and the difficulties that smaller developers would face without this resource. It sets out why without ground rent income; developers would have to establish a resident owned vehicle to manage the estate – along with some of the associated problems (which are also associated with right-to-manage companies):

- People with vested interests regularly take control;
- Difficulties in deciding who will sit on resident management boards;
- Resident management companies usually rely on service charges, with no commercial income – when residents do not pay services to tenants are severely restricted;
- When issues arise, leaseholders have little or no recourse and in cases like those with cladding issues, most resident owned blocks are unable to implement government or fire service recommendations swiftly, unlike ground rent owners.

The removal of ground rents and thus the freeholder, results in resident-managed schemes which have a range of associated problems. Although in Allison's view, leasehold reform is long overdue, the complete removal of ground rents is "short sighted and a blunt instrument to deal with this issue." He proposes that going forward; we need to better understand what the modern purpose of ground rents is and implement reforms accordingly.

Diary of forthcoming industry events

- Hardwicke Leasehold Conference 2018 (Tuesday 5 June, London)
- PBA Seminar – Leasehold Reform (Wednesday 3 October)
- Leasehold Reform Group half-day conference (TBC – early July)